1936

Examination questions May 1932 to November 1935 inclusive

American Institute of Accountants. Board of Examiners

EXAMINATION QUESTIONS

MAY, 1932 TO NOVEMBER, 1935

35

EXAMINATION QUESTIONS

PREPARED BY THE

BOARD OF EXAMINERS

OF THE

AMERICAN INSTITUTE OF ACCOUNTANTS

MAY, 1932, TO NOVEMBER, 1935, INCLUSIVE

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INTRODUCTORY NOTE

In this volume appears the text of examination problems and questions in accounting, commercial law and auditing set by the board of examiners of the American Institute of Accountants beginning with the papers of May, 1932, and including those of November, 1935.

It has always been the rule of the board of examiners that the official answers to questions should not be published, and the wisdom of this has been demonstrated in the light of experience. Nothing in the nature of an official answer can be final. Any examiner who adheres to a categorical compliance with a preconceived notion of an answer is not the man who should decide the eligibility and capability of candidates. The determination of individual ability and the interpretation of accounting principles should govern the grading of answers.

While no official answers are ever published by the Institute a great deal of assistance can be rendered to students and other candidates by an opportunity to review answers unofficially supplied to THE JOURNAL OF ACCOUNTANCY. Consequently, following the precedent established in 1931, the American Institute Publishing Co. Inc., will publish simultaneously with this book of questions another book containing the answers which have appeared in THE JOURNAL OF ACCOUNTANCY to the questions and problems which are here included.

A. P. RICHARDSON, *Editor.*

March, 1936.

Examinations, May, 1932, to November, 1935, inclusive

AMERICAN INSTITUTE OF ACCOUNTANTS

Examinations of May, 1932

Auditing

MAY 12, 1932, 9 A. M. TO 12:30 P. M.

Answer all questions, and be sure to give reasons when required.

No. 1 (10 points):

State in detail how you would audit and verify the notes receivable of a large trading corporation with several affiliated concerns.

No. 2 (10 points):

In auditing the annual report of the Town of X you find all the following items of receipts stated under the general head of "Revenues":

1. Taxes received
2. Loan from Bank of X
3. Dog licenses
4. Municipal court fines
5. Bequest from the estate of A to establish town library
6. Street assessments collected from owners of abutting property
7. Permits for parades
8. Sale of worn-out equipment
9. Transfer of balance from street opening to street-cleaning account
10. Deposit by B to cover cost of extra sewer connection
11. Interest on bank deposits
12. Donation from C toward repairs on his street
13. Annual payment under franchise by X Street Railway Co.

14. Fees from town clerk turned in
15. Rent of city dock to steamboat company
16. Assessments on members of police force for pension fund
17. Received from B balance of cost of extra sewer connection (see 10)
18. Newsstand privilege in city hall
19. Proceeds of paving bonds sold at 110
20. State grant for up-keep of state highway within town limits

Re-state these items to show true revenues of the town with titles of proper accounts to be credited; and indicate how the other items should be shown or treated.

No. 3 (10 points):

What is the value of a balance-sheet that bears only the signature of the auditor without any accompanying certificate? What is your opinion of such a statement?

No. 4 (10 points):

To what extent is it an auditor's duty to concern himself with the validity and legality of transactions coming within the scope of his audit?

No. 5 (10 points):

The A corporation has passed the cumulative preferred dividends on its stock for the past two years. How should this condition be shown, if at all, in published statements? Give reasons for your answer.

No. 6 (10 points):

The Y corporation was originally capitalized at nine million dollars as follows:

50,000 shares preferred stock, cumulative, $100 par.	$5,000,000
400,000 shares common stock, no-par, stated value $10	4,000,000

At the beginning of 1931 it had an earned surplus of

$500,000, but during the year it suffered an operating loss of one million dollars.

To avoid showing a deficit at the end of the year, the corporation induced its preferred stockholders to exchange their shares of par stock for an equal number of no-par shares with a stated value of $50 each, the new stock retaining all the guaranties of the original as to dividends, liquidating value and callable value.

After sundry intangible and doubtful assets had been written off, the corporation's balance-sheet as of December 31, 1931, showed (in totals):

Total assets	$9,000,000	Total liabilities.....	$1,500,000
		Preferred stock....	2,500,000
		Common stock.....	4,000,000
		Surplus	1,000,000
	$9,000,000		$9,000,000

Was this procedure in accordance with sound accounting principles? Would you give an unqualified certificate to the balance-sheet as stated? Give reasons for your answer.

No. 7 (10 points):

A man for whom you are making an audit and financial statement for credit purposes, has an account with a stock-broker which shows:

Stocks purchased on margin........	$100,000
Market value of stocks............	$125,000
Due broker	75,000

Your client requests you to show on his balance-sheet an item of "Stocks, $50,000." What would you do? Give your reasons.

No. 8 (10 points):

Give three methods by which a company investing in instalment loans (instalments received monthly) may take its income into the profit-and-loss account. State the comparative merits of several methods from the viewpoints of economics and of taxation.

No. 9 (10 points):

In 1914, Mr. Smith built a frame house costing $8,000 on land costing $2,000. He used it continuously as a residence until 1930 when he sold it for $9,000.

Mr. Smith's only income is his salary, $5,000, and he has deductible expenses for taxes, etc., of $500 and exemption as a married man with no dependents.

Indicate the way in which you would prepare his federal income-tax return for 1930 and the advice you would give him in regard to payment of the tax, if any.

No. 10 (10 points):

The X Company is engaged in lending money on real-estate first mortgages, on which principal and interest are payable in monthly instalments over the life of the mortgages. The company obtains a large part of its funds for loan purposes by issuing "insured mortgage bonds" maturing serially. The principal sources of the company's income are commissions on loans made and interest on these loans. The principal expenses comprise interest on its outstanding bonds, costs of investigating loans, surety and trustees' fees, office expenses, and amortization of discount and expense on the "insured mortgage bonds."

Interest on outstanding loans and on the "insured mortgage bonds" is regularly accrued by the company, and it takes its commission income into earnings in full during the month in which the loans are made.

You are called upon to make an audit of the X Company in behalf of investment bankers who expect to purchase an additional issue of the company's capital stock and offer it for sale to the public.

Assuming that your audit substantiates in all respects the technical correctness of the figures shown on the books, would you give an unqualified certificate to the resulting balance-sheet? Give reasons for your answer.

Accounting Theory and Practice—Part I

MAY 12, 1932, 1:30 P. M. TO 6:30 P.M.

The candidate must answer the first three questions and any two *of the remaining four questions.*

Answer no more than five *questions.*

No. 1 (25 points):

From the following trial balance and accompanying data you are required to prepare a balance-sheet, as at December 31, 1930, and a profit-and-loss account for the year ended that date:

COMPANY A, INC.

Trial-balance—December 31, 1930

	DR.	CR.
Cash	$260,000	
Accounts receivable—customers	520,000	
Furniture and fixtures	20,000	
Depreciation reserve—furniture and fixtures		$2,000
Auto. trucks	60,000	
Depreciation reserve—auto. trucks		20,000
Accounts payable—trade		45,000
Accrued payroll and property taxes		10,000
Capital stock		777,000
(Authorized and issued, 55,000 shares)		
Sales		720,000
Purchases—lumber, steel, etc	430,000	
Wages	225,000	
Depreciation—auto. trucks	20,000	
" —furniture and fixtures	2,000	
Lease rentals	25,000	
Selling and administrative expenses	12,000	
	$1,574,000	$1,574,000

Company A, Inc., rented display equipment on contract, and had obtained contracts for $720,000, covering a period of three years from January 1, 1930. The contracts provided that the company would bill for the earned portion of the contract price at the rate of $20,000 at the end of each month, beginning January 31, 1930.

The display equipment available for rental was constructed entirely by Company A, and during the month of January, 1930, such equipment was produced at a cost of $600,000, with an estimated average life of five years.

The locations on which the display equipment was erected had been leased to Company A for a period of five years from January 1, 1930, and the leases specified that rents for the full period were payable in advance on January 1, 1930.

All display equipment owned by Company A was in use under the contracts noted. Maintenance of this equipment in efficient operating condition cost the company $55,000 annually.

No. 2 (22 points):

On July 15, 1930, a fire occurred at the plant of the X Corporation. Two-thirds of the inventory on hand at that date and one-half of the capital assets were destroyed.

The corporation had procured a one-year fire-insurance policy on January 1, 1930, with coverage of $40,000 on both inventory and capital assets, at a premium of $600. After the fire the insurance company allowed the corporation the full amount of its claim, based on book values.

There was no salvage value in the property destroyed.

You are requested to prepare a balance-sheet as at July 15, 1930, and a statement of surplus for the period from January 1 to July 15, 1930, taking up as an account receivable the amount due from the insurance company.

While engaged in this work, you ascertain the following particulars: the inventory at January 1, 1930, was valued at $32,000; purchases from January 1 to July 15, 1930, amounted to $36,000; and recorded sales, for the same period, to $57,000. You find, however, that a sale of merchandise, which was not recorded, was made just prior to the fire. This sale resulted in a gross profit of $1,500 and was made at an advance of three-eights over cost.

A reconciliation with the bank statement, as of July 15, 1930, showed outstanding cheques, all dated July 10, 1930, as follows:

Payable to J. A. Jagger..............	$25.00
" " Marshall Company	62.50
" " United Savings and Loan Company—for deposit....	50.00
" " Lampey & Co............	402.00
	$539.50

Other items under date of July 15, 1930, were: Cashbook balance, $1,462; fixed assets and reserve for depreciation, $11,000 and $3,000 respectively; accounts receivable, $1,200; notes payable, $2,000; accounts payable, $2,600; and capital stock, $25,000.

A pass-book of the United Savings and Loan Company revealed a balance of $1,846 on July 1, 1930.

The surplus, January 1, 1930, was $13,000, and no entries had been made in the surplus account subsequent to that date.

From costing a representative number of recorded sales invoices, you determine that the gross profit amounted to forty-two and one-half per cent. (42½%) of cost.

No. 3 (25 points):

You are retained to audit the accounts of the S Manufacturing Company for the year ended December 31, 1931. Prepare a balance-sheet, in proper form, as at the close of that year, for submission to your client.

You are furnished with the trial balance from the company's books, as of December 31st, as follows:

	Dr.	Cr.
Cash in bank..................	$111,869.50	
Customers' notes	17,625.75	
Customer's accounts	228,429.20	
Reserve for bad debts.......		$21,610.25
Inventories	496,267.50	
Due from Canadian branch....	30,000.00	
Unexpired insurance	11,350.10	
Common stock held in treasury (1,400 shares)..............	118,200.00	
Land	28,000.00	
Buildings	225,000.00	

Machinery and equipment.....	$150,400.00	
Furniture and fixtures.........	22,600.00	
Reserve for depreciation.....................		$46,225.50
Patents	34,000.00	
Bond discount and expense....	24,000.00	
Bank loan		20,000.00
Accounts payable		37,150.00
Accrued wages		1,100.00
Accrued local taxes...........		4,000.00
First-mortgage, 6 per cent. bonds		450,000.00
Preferred, 6 per cent. stock ($100 par)		250,000.00
Common stock ($100 par)....		400,000.00
Surplus		279,893.80
Profit and loss...............		2,762.50
Dividends on preferred stock...	15,000.00	
	$1,512,742.05	$1,512,742.05

In the course of the audit, you obtain the following information:

(1) The first-mortgage, 6 per cent. bonds were issued February 1, 1929, and mature February 1, 1939. Interest is payable February 1st and August 1st, and has been entered on the books as paid. There has been no change in the bond-discount-and-expense account since the issuance of the bonds.

(2) The land and buildings are carried at appraised values, which are $48,500 more than cost. The adjustment to appraised values was credited to surplus in 1929.

(3) Included in customers' accounts is an account with the president of the company showing that he owes $24,750 for advances, less salary and other credits, and that he has consistently owed from $20,000 to $25,000 throughout the year.

(4) Beginning February 15, 1932, and annually thereafter, the company is obligated to deposit $25,000 in a sinking fund for retirement of the bonds.

(5) The regular quarterly dividend on the preferred stock was declared December 15, 1931, payable January 2, 1932.

(6) The company has discounted customers' notes aggregating $64,000.

(7) The Canadian branch was opened during the year. A trial balance from the books of the branch, at December 31, 1931, was as follows:

Cash	$10,000	
Accounts receivable	18,000	
Inventory	12,000	
Accounts payable		$10,000
Due to home office........		30,000
	$40,000	$40,000

The rate of Canadian exchange, at the date of the balance-sheet, was 85.

(8) The patent account represents the cost of rights to manufacture a certain device. The rights were acquired in June, 1930, to run for seventeen years.

No. 4 (14 points):

From the data following, prepare a summary of the inventory as at December 31, 1931, and justify your method as compared with other systems in general use:

	Units	Cost
Raw material purchased in 1931	6,250,000	$437,500
Produced during 1931	6,000,000	
At cost of—		
Labor		336,000
Factory expense		180,000
Depreciation		60,000
Scrap unrecoverable		30,000
On hand, December 31, 1931:		
Raw material	750,000	
In process (75% complete)	500,000	
Finished	250,000	

The company commenced operations January 1, 1921, with 500,000 units of raw material which cost $45,000. It manufactures a commodity composed of one uniform material, produced in one consistent form, which is billed to customers also by units.

Goods are manufactured on order only. They are in process about one month. About 500,000 units are on the machines at all times.

The market price of raw material December 31, 1931, was five cents a unit.

Unfilled orders (firm contracts) at December 31, 1931 (latest delivery date being March 31, 1932) were as follows:

Contract No.	Units	Sales price
787	100,000	$18,000

Contract No.	Units	Sales price
788	250,000	$50,000
789	50,000	9,500
790	300,000	63,000
791	200,000	36,000
792	225,000	40,500

No. 5 (14 points):

On December 31, 1929, Corporation Y, a holding company, owned 80 per cent. of the no-par-value common capital stock and 90 per cent. of the non-voting cumulative 7 per cent. preferred capital stock of Company A. Dividends on preferred stock had been paid to December 31, 1929.

The position of the capital account of Company A, and the holdings of Corporation Y, remained unchanged to December 31, 1931, no dividends having been paid during the years 1930 and 1931.

At December 31, 1929, Company A's books showed the following:

Capital stock, preferred—7 per cent. cumulative—issued and outstanding, 5,000 shares, $100 each	$500,000
Capital stock, common—no par value—issued and outstanding, 10,000 shares	50,000
Earned surplus—balance	9,091

Company A's operations for the year 1930 resulted in a net loss of $75,000, but during the year 1931 its net earnings were $140,000.

State the minority interests in Company A as they would appear in a consolidation of the accounts of Corporation Y and Company A at December 31, 1930, and also at December 31, 1931.

No. 6 (14 points):

Company A has 500,000 shares of capital stock issued and outstanding, owns 350,000 shares of capital stock of Company B and has a surplus of $1,050.

Company B has 400,000 shares of capital stock issued and outstanding, owns 45,000 shares of capital stock of Company A and has a deficit of $2,100.

A consolidated balance-sheet of companies A and B is being prepared. Determine the amount of the deficit ot Company B applicable to the minority stockholders' interest in that company.

No. 7 (14 points):

The Products Company, Ltd., Canada, keeps its records on a nominal dollar basis, and presents the following balance-sheet as at December 31, 1930:

Assets		
Cash		$10,000
Accounts receivable		300,000
Inventories		250,000
Fixed assets (U. S. dollar cost at date of acquisition)		100,000
		$660,000
Liabilities		
Notes payable		$15,000
Accounts payable		150,000
Due to parent company (U. S. dollars)		200,000
Capital		150,000
Surplus:		
Beginning of year	$25,000	
Profit for year	120,000	145,000
		$660,000

You are requested to convert this statement to a United States currency basis for consolidation with the parent company's balance-sheet. Assume that the Canadian dollar is worth $.80 in United States funds. Explain your treatment on each item.

The following information is available:

Accounts receivable—all Canadian funds
Notes payable—all Canadian funds
Accounts payable—$30,000 payable in Canadian funds and $120,000 in United States funds
Inventories—

Raw material purchased in Canadian funds........	$20,000
" " " " United States funds...	100,000
Goods in process..............................	130,000

This item includes material purchased both in United States and Canada, with labor all performed in Canada. The total purchases for the year average, approximately, 85 per cent. from United States and 15 per cent. Canadian. The labor cost approximates 13 per cent. of the cost of materials.

Assume no inter-company profit on materials purchased from the parent company.

Commercial Law

MAY 13, 1932, 9 A. M. TO 12:30 P. M.

An answer which does not state reasons will be considered incomplete. Whenever practicable, give answer first and then state reasons.

Group I

Answer all questions in this group.

No. 1 (10 points):

(a) Define the word "foreign" as used in the phrase "foreign corporation." Give an example of a foreign corporation.

(b) Define and give an example of de facto corporation.

(c) Can a corporation commit a crime? If so, give an example.

(d) Can a corporation commit a tort? If so, give an example.

No. 2 (10 points):

Jackson had obtained a judgment against Whitcomb for $4,334.08, but before taking legal steps to collect it he gave Whitcomb a written stipulation wherein Jackson agreed to accept in settlement of the judgment $1,000 in cash (payable in instalments), merchandise of the agreed value of $2,300, and an assignment of a certain patent. Whitcomb made and Jackson accepted the cash payments and the delivery of the merchandise but Jackson refused to accept the assignment of the patent. Can he compel Whitcomb to pay the balance of the judgment?

No. 3 (10 points):

A contract, signed by the seller and accepted in writing by the buyer, contained the following matter:

New York, Jan. 2, 1932.

To A. W. Jones Corp.,
2 Broadway, New York, N. Y.

Dear Sirs:

Herewith we confirm sale to you for the account of ourselves, through C. S. Smith & Co.: 25 tons (each 2,240 lbs. net) Chinese Antimony Regulus, 99%, @ 21¼¢ per lb., c.i.f. New York.

Shipment—Promptly from Hamburg.

Duty—For account of buyers.

Insurance—For account of sellers.

Payment—Net cash against shipping documents payable upon arrival of steamer. No arrival, no sale, but proof of shipment to be given by sellers.

At the time this contract was signed, the goods were in transit between China and Hamburg. The shipment arrived in Hamburg and was transshipped to New York. The shipment reached New York within the contract time. The invoice, receipt for freight, bills of lading, and other documents were not forwarded by the seller to the buyer but were tendered to the buyer after the goods had arrived. The insurance policies were issued to bearer "for account of whom it may concern" and were never tendered to the buyer. The bills of lading were through bills of lading and did not contain the name of the buyer as assignee.

(a) What does "c.i.f." mean?

(b) Is this contract a c.i.f. contract?

No. 4 (10 points):

On January 7, 1932, Baldwin drew a bill of exchange on Clute payable March 7, 1932, to the order of Dillingham. On January 12, 1932, Dillingham presented the bill to Clute who refused to accept it. On the same day, Dillingham protested the bill for non-acceptance. On January 27, 1932, Everett, who desired to protect Baldwin's credit, accepted this bill.

(a) What is the technical name for this kind of acceptance?

(b) How must such an acceptance be made?

(c) Just what did Everett, by this acceptance, engage to do?

No. 5 (10 points):

(a) Define and give an example of a limited partnership.

(b) May all partners in a limited partnership be limited partners?

(c) In what circumstances, if ever, can creditors hold a limited partner liable for partnership debts?

COMMERCIAL LAW

Group II

Answer any five *questions in this group. No credit will be given for additional answers, and if more than five answers are submitted only the first five will be considered.*

No. 6 (10 points):

(a) Define innkeeper.

(b) At common law, what right can an innkeeper exercise over goods in his possession brought by a guest?

(c) By what technical name is the innkeeper's right known?

(d) Can the innkeeper's right be exercised over goods brought in by the guest but actually belonging to some other person?

No. 7 (10 points):

(a) Where did the statute of frauds originate?

(b) What were the most important provisions of it?

No. 8 (10 points):

Collins, the bookkeeper and cashier for Watson, was bonded by a surety company. On January 14, 1932, Collins in the course of his employment stole $500 and Watson discovered this theft one week later. Watson notified the surety company but retained Collins in his employ because of sympathy for Collins' family and in reliance upon Collins' promise not to repeat the offense. On January 30, 1932, Collins in the course of his employment stole $750. On February 1, 1932, Watson discovered this theft, discharged Collins, and notified the surety company. For which, if either, of these losses can Watson recover from the surety company?

No. 9 (10 points):

Hart was the captain of a ship owned by the Dailey Corporation. Contrary to his general orders, Hart signed a bill of lading for goods which had not been received.

(a) Can the Dailey Corporation be held liable to an innocent third person who in good faith dealt with Hart in reliance upon the bill of lading?

(b) Upon what principle of law is your answer based?

No. 10 (10 points):

Monroe was the owner of two parcels of real estate, one known as 617 Grand Ave. and the other as 1014 Superior Ave. The former was worth $75,000 and the latter was worth $50,000. On January 4, 1929, Monroe borrowed $30,000 from Green on a three-year note secured by a first mortgage on both parcels. On January 11, 1929, Monroe borrowed $10,000 from Nelson on a three-year note secured by a second mortgage on the Superior Ave. property. Upon Monroe's default upon the payment of his note, Green foreclosed his mortgage on the Superior Ave. property and realized $30,000 from the foreclosure sale. Upon the maturity of Nelson's note, Monroe failed to pay it.

(a) Has Nelson any rights except to procure a judgment against Monroe?

(b) If Nelson has any such right, upon what principles of law is it based?

No. 11 (10 points):

(a) Define and give an example of personal property.

(b) Define and give an example of a pledge.

(c) Is transfer of possession essential to a pledge?

(d) What in general are the remedies of a pledgee upon the pledgor's default?

No. 12 (10 points):

In 1925 the Coombe Garment Company, a Pennsylvania corporation, distributed all of its assets among its stockholders and then dissolved. One Phillips had owned one-fourth of the company's stock and had received $17,139.61 as his distributive dividend. In 1931, the commissioner of internal revenue notified Phillips that he proposed to assess against and collect from him the entire income-tax deficiency of $9,306.36 legally assessed against but uncollected from the corporation. Pennsylvania had a six-months' statute of limitations on suits against stockholders. Any right which the commissioner may have had against Phillips had been kept alive by waiver. Has the commissioner a legal right to collect from Phillips?

Accounting Theory and Practice—Part II

MAY 13, 1932, 1:30 P. M. TO 6:30 P. M.

The candidate must answer the first three questions and one *other question.*

Answer no more than four *questions.*

No. 1.

a. (25 points):

The following balance-sheet is submitted to you by the president of the W M Company, makers of heavy machinery, who requests you to append your certificate thereto:

Balance-sheet, as at December 31, 1931

Assets

Current:	
Cash	$2,000,000
U. S. Government securities	2,500,000
Notes receivable—customers	240,000
Accounts receivable—trade	1,250,000
Accrued interest receivable	100,000
Inventories of raw material, work in progress and finished product	1,200,000
Prepaid insurance and taxes	75,000
Treasury stock—5,000 shares, common, at cost	1,200,000
Capital stock of associated company, at cost	1,000,000
Accounts receivable—associated company	750,000
Real estate and buildings—not in use and held for sale	1,500,000
Total current assets	$11,815,000

Fixed:		
Real estate, plant and equipment, at cost, less reserve for depreciation		8,000,000
Total assets		$19,815,000
Liabilities		
Current:		
Accounts payable		$1,250,000
Federal, state and other taxes		5,000,000
Total current liabilities		$6,250,000
Capital stock—authorized and issued:		
Preferred, cumulative, 7 per cent	$5,000,000	
Common	7,000,000	12,000,000
Surplus		1,565,000
		$19,815,000

Upon investigation, you obtain the following information:

(1) U. S. Government securities cost $2,600,000 and the market value at December 31, 1931, was $2,400,000.

(2) No reserve for probable losses on accounts receivable has been provided, but a loss of $150,000 is expected.

(3) Inventories were valued at the lower of cost or market.

(4) The market value of the 5,000 shares of treasury stock at December 31, 1931, was $900,000.

(5) An associated company used advances of $750,000, carried as accounts receivable, to erect a new plant. Excluding this liability the current liabilities of the associated company are 150 per cent. greater than its current assets.

(6) The cost of real estate and buildings, not in use and held for sale, was $2,500,000, and this has been reduced by depreciation to $1,500,000, by direct charges to surplus.

(7) After a careful examination and a discussion with the president, you estimate federal, state and other taxes at $2,500,000.

(8) Capital stock, authorized and issued, consists of 50,000 shares of 7 per cent. cumulative, preferred, of $100 par; and 70,000 shares of common, of $100 par.

(9) Upon analyzing the surplus account, you find that the company had purchased $3,000,000 of U. S. government securities at par, and charged the amount direct to surplus account. When verifying the securities on hand, you find these $3,000,000 bonds in addition to the securities actually recorded as assets. The market value of the $3,000,000 bonds, on December 31, 1931, was $2,760,000, and the interest has been accrued.

Would you certify this balance-sheet in its present form? If not, state your reasons, clearly and definitely, with reference to each questionable item.

b. (15 points):

Prepare an amended balance-sheet of the W M Company, as at December 31, 1931, which you would be willing to certify.

No. 2 (24 points):

At December 31, 1930, the "Investments" account on the general ledger of the X Company showed a balance of $83,400 made up as follows:

Company	No. Shares Common	Cost Date	Cost Amount
U. S. Steel Corporation.....	100	Apr. 7, 1930	$19,800
General Motors Corporation.	100	" 10 "	5,400
X Company	200	" 14 "	10,000
Y Company	600	" 18 "	42,000
Z Company	100	" 21 "	6,200
			$83,400

At this same date, a "Reserve for loss on investments" account was carried. This account had a credit balance of $36,900, constituted as follows:

U. S. Steel Corporation.................	$6,900
General Motors Corporation.............	1,900
X Company	1,000
Y Company	24,000
Z Company	3,100
	$36,900

The market prices of three of these stocks were:

	December 31	
	1930	1931
U. S. Steel Corporation	139	40
General Motors Corporation	35	22
X Company	45	20

No market quotations of the stocks of the Y and Z companies were available.

The common stock of X Company consists of 100,000 shares of $10 par value. Its books, before adjustment, show an operating surplus of $3,000,000 at December 31, 1930, and $2,800,000 at December 31, 1931, indicating a loss from operations for the year 1931 of $200,000.

The Y Company has 1,000 shares of no-par common stock issued and outstanding. On the books of this company, the common stock is carried at $10,000 and the earned-surplus account shows a credit balance of $20,000 at December 31, 1930, and $15,000 at December 31, 1931.

Statements of the Z Company indicate that its capital stock outstanding consists of 10,000 shares of $10 par value, and that its surplus at December 31, 1930, was $210,000, and at December 31, 1931, $180,000.

On May 12, 1931, the X Company sold 100 shares of its treasury stock for $3,500, and on August 31, 1931, purchased 500 shares of its outstanding stock for $15,000. On October 31, 1931, it purchased 100 shares of the American Telephone and Telegraph Company for $13,700. The market price of this stock on December 31, 1931, was $120 a share. On December 21, 1931, it sold the 100 shares of General Motors Corporation for $2,300. All these transactions were charged or credited to the "Investments" account.

Indicate exactly how you would show the transactions, with their respective balances, in preparing the balance-sheet as at December 31, 1931, and also in the related statements of surplus and profit and loss.

No. 3 (22 points):

The X Company sells a loose-leaf service for $115 and contracts to issue to customers renewal and replacement pages semi-annually on April 1st and October 1st, for $15 per annum.

The initial purchase price covers the original publication and one year's renewal pages, and customers are billed in advance for each subsequent year's renewal pages on the anniversary dates of the original sales.

The company's books at December 31, 1931, showed the following transactions:

Sales of original publication (uniformly 200 sets a month), 2,400 sets @ $115	$276,000
Sales charges for renewal pages, 4,500 sets @ $15	67,500

Sales of original publication for preceding years were—

1927	50 sets a month
1928	75 " " "
1929	100 " " "
1930	150 " " "

The production cost of the original publication was $30 per set and that of renewal pages $2.50 per semi-annual issue.

The company credited the foregoing sales of both categories to profit and loss, in closing its records for the year 1931, in accordance with the uniform practice since the initiation of this particular department.

As auditor, would this procedure meet with your approval? State what modifications you would suggest, showing the actual gross profits from both sources for the year 1931 and the adjustments applying to other periods.

No. 4 (14 points):

A corporation acquired several tracts of industrial property during the year 1921 to be held solely for the purpose of investment. In the following year the properties were revalued in accordance with appraisals, and these revaluations were taken up on the books. The difference between cost and appraisal values was credited to capital-surplus account.

In the year 1927, the corporation sold one of the industrial tracts for $25,000, payable in instalments over a period of years, as evidenced by first-mortgage notes signed by the purchaser.

The book value of the particular tract sold was as follows:

Cost	$3,000
Appreciation	8,000
Total book value	$11,000

The sale was recorded as a closed transaction when it was consummated, and the profit-and-loss account was credited with the profit from the sale.

The notes, in the aggregate amount of $25,000, were immediately endorsed, with recourse, and were discounted for the corporation by the bank.

In the year 1930, the purchaser defaulted in his payment of the notes and the holders of the notes looked to the corporation for payment. In order to protect itself, it was necessary for the corporation to foreclose the mortgage, and in the proceedings the tract was repossessed by the corporation. At the time of foreclosure, the purchaser's unpaid notes, still outstanding, amounted to $18,000.

In financing the repossession of the tract, the corporation issued its notes, in like amounts, to the holders of the old notes. However, the entries to record the repossession of the property had not been placed on the books at December 31, 1930.

If you were conducting an audit of the accounts of the corporation, as at December 31, 1930, and all this information came to your knowledge, what entries would you recommend to record all the transactions incident to the repossession of the industrial tract?

State your answer in the form of journal entries, giving complete explanations.

No. 5 (14 points):

On the cost ledger of a fabric mill there is maintained a separate account for each department. One, engaged solely in "winding," is known as department C.

Under date of January 1, 1932, the following information was obtained with respect to department C.

The inventory of wound goods, by weight 795.34

pounds, was valued at $4,056.23, and labor in process totaled $79.53. The average cost of material was $5.10 per pound, and the estimated average cost of winding was 10 cents per pound. No unwound goods were on hand either at the beginning or at the end of the month.

The charges to this department for unwound material, during the month of January, 1932, were by weight 3,613.83 pounds and for actual labor expended thereon $415.

The credits for wound goods delivered during the month of January, 1932, were

To department		D	3,612.68	pounds
"	"	E	9.10	"
"	"	F	60.38	"
"	"	G	10.13	"

On the basis of these data, submit the following, as of January 31, 1932:

(a) Ledger account for department C.
(b) Balance of goods in this department and their value, also showing estimated labor thereon.
(c) Difference between estimated and actual cost of labor.
(d) Actual average cost of winding for the month of January.
(e) Total of charges to the succeeding departments on the basis of estimated labor cost.

Examinations of November, 1932

Auditing

NOVEMBER 17, 1932, 9 A. M. TO 12:30 P. M.

Answer all the following questions:

No. 1 (10 points):

Auditing a corporation in the state of X for the calendar year 1931, you find on its profit-and-loss statement "Taxes paid, $4,200." The ledger account shows the following items:

'Feb.	1	State real-estate tax—½ of 1930..	$1,200	
May	1	" " " " —½ " 1931..	1,200	
Nov.	1	" " " " —½ " 1931..	1,800	
Dec.	31	Contra to profit & loss...........		$4,200"

Supporting tax bills show that the assessments cover periods for one year from July 1st, agreeing with the state's fiscal year, the taxes being due and payable in two instalments, November 1st and May 1st.

You also discover an unrecorded unpaid bill for a state franchise tax of $3,000, due and payable November 1, 1931, for one year in advance.

Give your analysis of the items, and state how they should be treated.

No. 2 (10 points):

A bank engages you to audit the accounts of the Smith Manufacturing Company, which is seeking a loan. You find that the company is not incorporated and that A. B. Smith is the sole owner of the business.

How far will you go in determining and setting out in your report the personal assets and liabilities of Mr. Smith? State your procedure.

No. 3 (10 points):

State the method of verifying the following accounts in the audit of a stock-brokerage firm.

(a) Customers' accounts (cash balance and securities).

(b) Failed to deliver.

(c) Failed to receive.

No. 4 (10 points):

In 1925 your client, a corporation, issued 100,000 shares of cumulative preferred stock. In 1927 it repurchased 20,000 of these shares and held them as treasury stock until 1932 when it sold them at cost. Dividends for 1930 and 1931 on the preferred stock were suspended, but were declared in 1932 together with the dividend for that year.

You find that the dividends on the 20,000 shares of treasury stock for 1928 and 1929 were entered on the books as income to the corporation, as were also the suspended dividends when declared in 1932, the purchasers of record of these shares receiving only the dividend for 1932.

How will you deal with this matter? Give your reasons.

No. 5 (10 points):

(a) Define "trade acceptance." (b) What is its distinguishing characteristic? (c) As compared with customary trade methods of book accounts what are its advantages and disadvantages (1) to the parties thereto, (2) to the auditor, and (3) to business in general?

No. 6 (10 points):

The A. B. Corporation lends money to its customers, taking their notes secured by warehouse receipts for merchandise in storage. All these notes, together with the warehouse receipts, are pledged by the corporation to secure bank loans.

What steps should the auditor take to verify the notes receivable at the date of his balance-sheet?

No. 7 (10 points):

You are invited to address a regional bankers' convention on the subject of internal check in handling loans and discounts. Give an outline of what you would suggest.

No. 8 (10 points):

In conducting an audit of a wholesale company, you note the following accounts on the general ledger:

Cash discounts lost (debit balance).........	$1,432.73
Cash discounts not taken (credit balance)...	5,733.40

What, in your opinion, is the meaning of these accounts, and how will you dispose of them in preparing the income statement of the business?

Submit pro-forma journal entries illustrating a purchase and a sale under the procedure obviously followed by the company.

No. 9 (10 points):

State three methods of treating cash discounts on sales in the income statement and discuss the reasons for each.

No. 10 (10 points):

In making an audit of a recently organized utility corporation, you find an entry on the books, supported by resolution of the board of directors, as follows:

"Franchises, Dr.	$50,000	
To Surplus		$50,000
To set up expenditures by incorporators prior to date of incorporation in connection with securing franchises."		

State what you would do and your reasons therefor.

Accounting Theory and Practice—Part I

NOVEMBER 17, 1932, 1:30 P. M. TO 6:30 P. M.

The candidate must answer questions 1 and 2, 3 or *4 and 5* or *6.*

No. 1 (30 points):

You are called upon by the president of a corporation to restate the operating accounts of the company. The chief accountant has recently remodeled the general ledger, introducing accounts for cost of sales, work in progress and other accounts appertaining to the operations. These accounts are maintained in the general ledger, no separate factory ledger having been opened.

At the end of the first month under the new system, the chief accountant has submitted to the president a statement of operations showing:

Net sales	$75,000
Cost of sales	43,700
Operating profit	$31,300

The president has then asked that figures be submitted showing inventories at the beginning, purchases, payrolls, etc., but the chief accountant has met with a serious accident and no one else in the office has been able to furnish the desired information. You are requested to do this.

Show how you would obtain the desired information and state what suggestions you would offer in order that cost of sales could readily be analyzed in the future.

The operating accounts and journal entries are as follows:

LEDGER

Raw materials

Inventory	$30,000	Issues	$25,500
Voucher record	20,000		

Work in progress

Inventory	$20,000	Cost of sales	$43,700
Raw materials	24,000	Power house	320
Stores	10,000	Plant account	1,500
Voucher record	1,500		
Labor	5,150		
Overhead	6,870		

Foundry overhead

Stores	$ 900	Work in progress	$ 1,950
Voucher record	125		
Labor	125		
Power	400		
Depreciation	300		
Insurance	125		
Taxes	75		

General plant expense

Raw materials	$ 1,000	Work in progress	$ 1,170
Stores	1,300		
Voucher record	275		
Labor	225		
Pattern shop overhead	150		
Depreciation	80		
Insurance	25		
Taxes	20		

Labor—Pattern shop

Voucher record......	$ 650	Sundries	$ 650

Stores

Inventory	$10,000	Issues	$15,150
Voucher record......	7,500		

Pattern shop overhead

Stores	$ 1,150	Work in progress...	$ 500
Voucher record......	50	General plant expense	150
Labor	75		
Power	240		
Depreciation	100		
Insurance	50		
Taxes	30		

Machine shop overhead

Stores	$ 1,500	Work in progress...	$ 3,250
Voucher record......	350		
Labor	275		
Power	800		
Depreciation	480		
Insurance	200		
Taxes	75		

Power house

Raw materials—Coal, etc.	$ 500	Pattern shop........	$ 240
Stores	150	Foundry	400
Labor	350	Machine shop........	800
Depreciation	140	General offices.......	160
Insurance	100		
Taxes	40		
Work in progress...	320		

Labor—Foundry

Voucher record......	$ 1,950	Sundries	$ 1,950

Labor—Machine shop

Voucher record......	$ 3,250	Sundries	$ 3,250

JOURNAL ENTRIES

1

Work in progress...........................	$24,000	
Power house	500	
General plant expense.......................	1,000	
Raw materials		$25,500
Summary of materials used during month.		

2

Work in progress...........................	10,000	
Pattern-shop overhead	1,150	
Foundry "	900	
Machine-shop "	1,500	
Power house	150	
General plant expense.......................	1,300	
Employees' accounts receivable...............	150	
Stores		15,150
Summary of requisitions for the month.		

3

Plant and equipment........................	5,000	
Work in progress...........................	1,500	
Raw materials	20,000	
Stores	7,500	
Employees' accounts receivable...............	150	
Advertising	700	
Prepaid insurance	1,250	

Pattern-shop overhead	$50	
Foundry "	125	
Machine-shop "	350	
General plant expense	275	
Salaries	5,000	
Labor—Pattern shop	650	
" —Foundry	1,950	
" —Machine shop	3,250	
" —Power house	350	
Traveling expense	350	
General expense	650	
Accounts payable		$49,100
Summary of voucher record for the month.		

4

Work in progress	5,150	
Pattern-shop overhead	75	
Foundry "	125	
Machine-shop "	275	
General plant expense	225	
Power house	350	
Labor—Pattern shop		650
" —Foundry		1,950
" —Machine shop		3,250
" —Power house		350
Distribution of payrolls.		

5

Work in progress	6,870	
General plant expense	150	
Pattern-shop overhead		650
Foundry "		1,950
Machine-shop "		3,250
General plant expense		1,170
Distribution of overhead for the month.		

6

Plant and equipment	1,500	
Power house	320	

Cost of sales................................	$43,700	
Work in progress........................		$45,520
Cost of shipments during month.		

7

Power house................................	280	
Pattern-shop overhead........................	180	
Foundry "	500	
Machine-shop "	755	
General plant expense....................	125	
Prepaid insurance........................		500
Reserve for depreciation................		1,100
Accrued taxes (property)..............		240
For proportions applicable to factory, viz.:		

	Depreciation	Insurance	Taxes	Total
Power house.	$ 140	$100	$ 40	$ 280
Pattern shop.	100	50	30	180
Foundry	300	125	75	500
Machine-shop..	480	200	75	755
General plant.	80	25	20	125
	$1,100	$500	$240	$1,840

8

Pattern-shop overhead........................	$ 240	
Foundry "	400	
Machine-shop "	800	
General office................................	160	
Power house..............................		1,600
Distribution of overhead for month.		

No. 2 (30 points):

You are engaged by a certain professional association, founded January 1, 1929, to audit the books of account and records for the period of one year and six months ended June 30, 1931. The purpose of this organization is to promote the welfare of the profession. To this end it engages in various activities, principally the publication of monthly bulletins containing data of interest to its members. These bulletins are printed by outside printers and are mailed each month to the membership. At the end of the year, additional bound volumes of the twelve issues are available to the members for $8.60 a volume. Extra copies of the monthly bulletin are sold at 50 cents each.

The membership dues are $10 per annum, payable in advance, and it is customary to charge the members with the full year's dues on January 1st. All dues for 1931 are paid.

A trial balance of the books as at June 30, 1931, before audit adjustments, was as follows:

Cash in bank	$ 5,300	
Accounts receivable—members	11,250	
" " —advertising	625	
Inventory of publications—December 31, 1930	20,800	
Accrued interest receivable	200	
Stocks and bonds	15,000	
Furniture and fixtures	5,400	
Prepaid insurance	70	
Accounts payable		$ 2,700
Reserve for depreciation		1,250
Surplus		37,748
Membership dues—1931		32,500
" " —1932		1,500
Sales of bulletins		4,442
" " advertising matter		3,250
Interest on investments		300
Salaries	10,000	

Printing bulletins	$11,420	
Office expense	2,455	
Depreciation	270	
Binding	900	
	$83,690	$83,690

The profit-and-loss account for the year ended December 31, 1930, as disclosed by items in the surplus account on the books, was as follows:

	1930
Membership dues—1930	$38,000
" " —1931	400
Sales of bulletins	9,840
" " advertising matter	4,450
Interest on investments	700
Total	$53,390
Opening inventory	17,600
Binding bulletins	900
Printing bulletins	22,940
Total	$41,440
Closing inventory	20,800
Remainder	$20,640
Salaries	17,700
Office expense	2,600
Depreciation	525
Total	$41,465
Net profit to surplus	$11,925

Inventories of publications (by quantities) on hand, at closing dates, were as follows:

	Bound sets	Unbound sets	Single bulletins
June 30, 1931:			
1931	..		11,000
1930	250	700	1,500
1929	1,380	1,100	3,500
December 31, 1930:			
1930	300	700	2,000
1929	1,500	1,100	3,700
December 31, 1929:			
1929	1,900	1,100	4,100

The cost of printing is 30 cents a bulletin, and the cost of binding $3 a volume. During the period under review, 6,000 copies of each month's bulletin were printed.

The liabilities as at June 30, 1931, are all shown on the books.

It is agreed that the bound and unbound bulletins for the year 1929 are to be written down to one-half on December 31, 1930; and on June 30, 1931, to one-quarter of their cost. The bulletins for 1930 are to be written down to three-quarters of their cost on June 30, 1931.

You are required to prepare the following statements:

(a) Balance-sheet as at June 30, 1931.

(b) Income statements for the year 1930 and for the six months ended June 30, 1931.

(c) Statement showing opening and closing inventories, purchases, distribution and sales of bulletins for each period. Show quantities and amounts.

Submit your working papers.

No. 3 (25 points):

The X Y Z Syndicate was formed April 1, 1928, and purchased a parcel of vacant city land for the sum of $215,500, the purchase being financed by (a) funds invested by the participants, (b) proceeds of a second mortgage on the property and (c) purchase-money mortgage issued to the vendor.

The syndicate agreement provided that a trustee should hold title to the property, that each of the three participants would be the equitable owner of a one-third interest, that capital should be contributed to the venture in proportion to the respective interests and that interest at the rate of 6 per cent. per annum should be allowed on capital.

Declining real-estate values rendered it impossible to sell the property.

No books were kept, but cheque stubs of the syndicate's bank account revealed the following:

Deposits:

1928		
Apr. 1	Received from X	$34,000
	" " Y	21,000
	" " Z	20,000
Oct. 1	" " X	5,000
1929		
Apr. 1	Bank loan—3 months—guaranteed by X	50,000
	Received from X	4,000
	" " Y	2,000
	" " Z	2,500
May 1	Sign-board rentals for one year	7,500

1930		
May 1	Received from X	$5,000
	Sign-board rentals for one year	7,500
1931		
May 1	Received from Y	2,500
	" " Z	2,500
1932		
Apr. 1	Received from X	2,000
	" " Y	2,000
	" " Z	2,000
Payments:		
1928		
Apr. 1	Account of purchase price	70,000
30	Taxes	2,995
May 10	Legal fees	1,000
Oct. 1	Interest on purchase-money mortgage (6%)	3,000
	" " second mortgage (6%)	1,500
1929		
Apr. 1	Interest on purchase-money mortgage	3,000
	" " second mortgage	1,500
	Second mortgage paid	50,000
	Discount on bank loan	750
30	Taxes	3,434
July 1	Discount on loan renewed	750
Oct. 1	" " " "	750
	Interest on purchase-money mortgage	3,000
1930		
Apr. 1	Interest on purchase-money mortgage	3,000
30	Taxes	4,225
Oct. 1	Interest on purchase-money mortgage	3,000
1931		
Apr. 1	Interest on purchase-money mortgage	3,000
30	Taxes	4,150
Oct. 1	Interest on purchase-money mortgage	3,000

1932			
Apr.	1	Interest on purchase-money mortgage.......	$3,000
	30	Taxes	3,874

Prepare such statements as you would submit to the participants in this venture, as of June 30, 1932.

No. 4 (25 points):

Henry White, a partner in the investment-banking firm of Black & White, died on December 31, 1931.

The assets and liabilities of the firm, at that date, were as follows:

Cash in bank.....................	$11,526.90	
Life-insurance funds receivable.....	44,700.02	
Marketable securities	978,663.77	
Notes and accounts receivable......	23,268.63	
Bonds of Kiln Lumber Co., bankrupt, at 25 per cent. of par............	56,250.00	
Seventy-five per cent. interest in logs, lumber, machinery and logging equipment	22,604.25	
Notes payable		$500,000.00
Accrued interest		1,500.00
Liability as guarantors of note of Kiln Lumber Co., bankrupt......		38,170.31
Accounts payable		14,357.33
Agreement to repurchase $10,000 bonds of Kiln Lumber Co. at 97½.		9,750.00
Capital—James Black, 40 per cent.. .		229,294.37
" —Henry White, 60 " " ..		343,941.56
	$1,137,013.57	$1,137,013.57

James Black, surviving partner, was appointed trustee to continue the business for a limited period of time.

The transactions to September 30, 1932, were as follows:

The amount due for life insurance was collected.
$712,554.07 was realized on securities which cost $619,483.
$3,725 was expended in exercising rights, the original and newly acquired shares being among those unsold at September 30th.
Notes and accounts receivable realized $17,429.30, but of the balance outstanding at September 30th only $1,000 was considered good.
Foreclosure proceedings were instituted on the bonds of the Kiln Lumber Co. In the final settlement, $4,603.97 was realized in cash and the firm acquired a three-fourth's interest in 10,000 acres of timber lands.
The interest in logs, lumber, machinery and logging equipment realized $2,725.09
A claim receivable for damages, which was pending December 31, 1930, but not entered on the books, was settled for $3,000.
Notes payable, with interest, amounting to $27,500, were paid.
The liability as guarantors of the note of the Kiln Lumber Co. was discharged by payment of $36,149.73.
One $1,000 bond of the Kiln Lumber Co. had been lost or stolen and, therefore, could not be produced. The remaining bonds were repurchased.
The accounts payable, together with an additional item of $1,275 owing at December 31st but not discovered until later, were duly paid.
The sum of $200,000 was withdrawn in the proportion of the partner's investments.
Expenses incurred, exclusive of interest, totaled $7,328.30, of which $432.15 were unpaid September 30, 1932.
Income amounted to $14,732.03, of which $2,500 had not been received September 30, 1932.

Prepare a statement, in suitable form, for the use of the trustee and of the executor of the estate of the deceased partner.

No. 5 (15 points):

The superintendent of a cheese manufactory reports the following results of a test-run:

46,153 pounds of milk were purchased at the contract price of $3.10 per cwt., on the basis of a butter-fat content of 3.5 per cent., with a premium or discount of 4 cents per cwt., on account of variations from the standard, the total cost being $1,647.66. From this milk, 5,976 pounds of cream, having a butter-fat content of 20 per cent., were sold at a price of 58 cents a pound of butter fat, the remainder yielding 4,491 pounds of uncured cheese, known as No. 1.

The whey from the milk used weighed 29,280 pounds, to which was added 1,384 pounds of whole milk from the purchases of the following day, the combined fluid yielding 1,821 pounds of uncured cheese known as No. 2.

The No. 1 cheese is subject to a shrinkage of 12.3 per cent. in curing, and the No. 2 to a shrinkage of 33 per cent.

From the foregoing data, determine the material cost per pound of cured cheese and the yield per cwt. of milk.

For this purpose, you may assume the value of whey to be 50 cents per cwt., and the price of the whole milk used in the process of the second day the same as that used on the first day.

No. 6 (15 points):

A joint-stock land-bank loan of $1,000 is repayable in 65 semi-annual instalments of $35 each and a final payment of $29.23 at the end of the 33rd year. These payments include interest at the nominal rate of 6 per cent. per annum compounded semi-annually.

What is the amount of the balance at the end of the 20th year? Given at 3 per cent.

v^{40}	.3065568	$(1+i)^{40}$	3.2620378
v^{26}	.4636947	$(1+i)^{26}$	2.1565913
v^{25}	.4776056	$(1+i)^{25}$	2.0937779

What amounts of principal and interest respectively were contained in the fortieth payment?

Commercial Law

NOVEMBER 18, 1932, 9 A. M. to 12:30 P. M.

An answer which does not state reasons will be considered incomplete. Whenever practicable, give answer first and then state reasons.

Group I

Answer all questions in this group.

No. 1 (10 points):

Wolff was the selling agent for Knox Mills, Inc., and since 1924 had owned 100 shares of its common stock. Claghorn was president of the corporation Wolff and Claghorn executed a contract under seal whereby Claghorn agreed to purchase Wolff's stock at par value at any time upon Wolff's request. Wolff gave Claghorn the right to purchase it if Wolff's contract with the corporation should terminate or at any time within 30 days after Wolff's death. The stock certificate was endorsed as follows: "This certificate is subject as to transfer to a certain agreement made between Jacques Wolff and Edwin B. Claghorn, dated November 15, 1926." This contract was made binding upon and to enure to the benefit of the executors, administrators and assigns of each party "provided that no assignment of this agreement shall be made by said Wolff without the written consent of said Claghorn." On November 3, 1930, Wolff duly requested Claghorn to purchase this stock and tendered it to him. Clag-horn refused to purchase it on the ground that the contract was void for lack of mutuality and of consideration. Is this contract valid?

No. 2 (10 points):

Dupont drew a cheque on the X bank for $1.22 payable to the order of Alice Nugent. This cheque was fraudulently raised to $3,881.22 and the name of the payee changed to Alfred Nugent. Thereafter, this cheque was endorsed by Alfred Nugent and deposited by him in the B bank. The B bank endorsed it, guaranteeing all prior endorsements, and collected $3,881.22 from the X bank. Prior to the discovery of the fraud, Alfred Nugent closed his account with the B bank and disappeared. Upon whom does the loss fall and why?

No. 3 (10 points):

A boy, twelve years old, whose mother had died and whose father had abandoned him, was being supported by a man who had known both of the boy's parents for several years but who was not related in any way to the boy. One year after this support began, the man procured insurance on the boy's life payable to the man as beneficiary. Two years thereafter the boy died. At all times, from the date of the application for the policy until the boy's death, the insurance company's general agent and its local agent or solicitor knew all of the facts and circumstances of the case. Is the policy valid?

No. 4 (10 points):

Mark Talbot was insolvent. In order to obtain a loan of $500,000 from Clark Gibbons, Talbot was compelled by Gibbons to purchase from him, for $378,000, a residence property known to be worth $250,000, and certain corporate stock of no market value for $80,000. Talbot signed a note payable to the order of Gibbons carrying interest at the legal rate of 6%.

(a) At maturity, will the note be enforceable by the payee?
(b) At maturity, will the note be enforceable by a holder in due course?

No. 5 (10 points):

Theodore Crawford, in November, 1925, subscribed for 100 shares of the preferred stock of the M Corporation and paid $2,000 to the corporation on account. Crawford was induced to make and did make this subscription wholly because the corporation's treasurer had formally represented to him that the corporation had a surplus at July 1, 1925, and had legally paid a dividend in the month of July, 1925. Crawford sued for the rescission of his contract and the recovery of the $2,000, and the following facts were proved: On January 1, 1925, the corporation's books showed a deficit of $11,484.29. In the following May, a journal entry was made debiting deferred engineering and development expense and crediting surplus with $22,-167.95 for "expenses charged off in 1924, deferred to future operations." This amount was 80% of the

1924 expenditures for engineering. At the same time the corporation paid $10,000 for 400 shares of its own common stock, which it proceeded to carry at an asset value of $10,000, although the book value immediately prior to this purchase was $6.27. The corporation declared and paid a dividend of $1,591.55 in July, 1925.

(a) On the facts as stated, should Crawford succeed in his action?

(b) If the facts as stated should be amplified, indicate the lines along which further inquiry should be made.

Group II

Answer any five questions in this group. No credit will be given for additional answers, and if any are submitted only the first five answers will be considered.

No. 6 (10 points):

A debtor of the X bank, in liquidation, offered to compromise his indebtedness by the payment of $2,074.10. The state superintendent of banks agreed to consider this offer on condition that the debtor deposit the money in escrow and submit to an audit, and on condition, also, that acceptance of this offer be approved by the court having jurisdiction of the liquidation. The deposit was made and the audit completed but the debtor died prior to acceptance of the offer by the superintendent. The debtor's executor immediately demanded the return of the escrow deposit. Is he entitled to it?

No. 7 (10 points):

Charles Little on his own behalf contracted to sell 1,500,000 gallons of molasses of the usual run from a specified sugar refinery, deliveries to begin three months after the date of the contract of sale. At no time did Little have a contract with the refinery. Shortly after deliveries began, the refinery curtailed its output, for economic reasons, although there was no failure of the sugar crop and no fire or other accident or strike at the refinery. The refinery refused to sell to Little a sufficient quantity to enable him to deliver all of the 1,500,000 gallons. Has Little any valid defense in an action brought against him by the vendee for failure to deliver?

No. 8 (10 points):

Belknap, for an adequate consideration, gave the following written instrument to Pinney on August 5, 1932:

New York, N. Y.

Thirty (30) days after date I promise to pay to the order of Albert Pinney One Thousand Seven Hundred Fifty Dollars ($1,750) at Liberty Trust Company. Value received. Interest at 6%.

Robert Belknap
James Silliman
Agents of New York Turbine Company.

Against whom, when, and for what amount will Pinney be entitled to enforce this instrument?

No. 9 (10 points):

(a) What circumstances can cause the dissolution of a partnership?

(b) Does dissolution necessarily result in the actual termination of the business formerly conducted by the partnership?

(c) What authority has a partner after dissolution?

No. 10 (10 points):

In September, 1928, Stone was 20 years and 6 months of age. He opened a margin account with stockbroker X and did a certain amount of trading. One month later he transferred to X a similar account which he had with broker Y and caused to be delivered to X 400 shares of the then market value of $17,450. X paid Stone's debit balance of $13,907.91 to broker Y, thus leaving Stone an equity of $3,542.09 in these 400 shares. Two months later Stone closed his account with X, receiving from X $70.99 in full payment of his credit balance. Six weeks thereafter Stone rescinded his agreement with X, disaffirmed all of his transactions with X, and sued X to recover the amount of his equity in the 400 shares ($3,542.09) minus the $70.99 paid to him by X upon the closing of his account. Stone in June, 1928, had deposited $4,000 cash as a margin with broker Y. At the time of Stone's disaffirmance of his agreement with X, the 400 shares transferred from Y had a market value of $14,227. How much, if any amount, can Stone recover from X?

No. 11 (10 points):

A corporation's certificate of incorporation or charter provided in article A that holders of preferred stock should be entitled out of surplus or net profits to cumulative dividends at 7%. Article E stated that in any liquidation or dissolution the preferred stockholders "shall be entitled to be paid in full the par value thereof and all unpaid dividends accrued thereon before any amount shall be paid or any assets distributed to the holders of the common shares." Article F read: "The preferred stock shall be subject to redemption at $110 per share plus all unpaid, accrued, or accumulated dividends thereon." The corporation was dissolved and after the payment of all creditors the funds available for distribution did not amount to the total par value of the outstanding preferred and common stock. At the time of dissolution no declared dividends remained unpaid and the preferred stockholders had received annually the full amount of their 7% dividends. How should the available funds be distributed between preferred and common stockholders?

No. 12 (10 points):

(a) What are the principal changes in the income-tax provisions of the revenue act of 1932 as compared with the revenue act of 1928?

(b) Explain, and illustrate by a simple example, how the gift tax will be computed (knowledge of the rates prescribed in section 502 is not required).

Accounting Theory and Practice—Part II

NOVEMBER 18, 1932, 1:30 P. M. TO 6:30 P. M.

The candidate must answer questions 1 and 2, and any two *of the* three *following questions:*

No. 1 (36 points):

From the following data, you are required to prepare a consolidated balance-sheet of company A and subsidiaries, as at December 31, 1931, including an analysis of consolidated surplus for 1930 and 1931.

		Date	Cost
1. Acquisitions			
	A—20 per cent. of stock of B	Dec. 31, 1929	$180,000
	A—45 " " " " " B	Mar. 31, 1930	400,000
	A—25 " " " " " B	Sept. 30, 1930	270,000
	90 per cent.		$850,000
2.	A—20 per cent. of stock of C	Dec. 31, 1930	
	B—60 " " " " " C	Dec. 31, 1931	
	A—95 " " " pref. stock of D	Dec. 31, 1930	
	A—80 " " " com. " " D	Dec. 31, 1930	
	A—20 " " " stock of E	Dec. 31, 1930	

3. The profits of B for the year 1930 were earned as follows:

First quarter	$30,000
Second "	50,000
Third "	70,000
Fourth "	75,000
	$225,000

4. B drew a cheque for $5,000 in favor of A on December 31, 1931, which was not received and therefore not recorded by A until January 2, 1932.

5. Included in the inventories of B, at December 31, 1931, were goods purchased from A in 1931, amounting to $100,000, on which A had taken up a profit of 20 per cent.
6. A has included dividends received from B and E in its profits.
7. The preferred stock of A is 7 per cent. cumulative, and dividends have been paid thereon to December 31, 1931. The preferred stock of D is 6 per cent. non-cumulative and non-participating, and dividends have been paid to December 31, 1930.

The balance-sheets of the several companies, as of December 31, 1931, were as follows:

Assets	A	B	C	D	E
Cash	$100,000	$95,000	$25,000	$10,000	$30,000
Receivables	540,000	425,000	145,000	20,000	70,000
Inventories	500,000	400,000	100,000	50,000	25,000
Advances:					
To A	....	100,000	....	....	....
To C	....	60,000	....	....	....
To D	110,000	....	....	....	....
Investments:					
In stock of B (90%) at cost	850,000	....	....	....	....
In stock of C (20%) at cost	40,000	....	....	....	....
In stock of C (60%) at cost	....	130,000	....	....	....
In preferred stock of D (95%) at cost	95,000	....	....	....	....
In common stock of D (80%) at cost	40,000	....	....	....	....
In stock of E (20%) at cost	15,000	....	....	....	....
Fixed assets	1,500,000	450,000	150,000	100,000	50,000
Goodwill	....	....	20,000	20,000	....
	$3,790,000	$1,660,000	$440,000	$200,000	$175,000
Liabilities and Capital					
Accounts payable	$535,000	$420,000	$155,000	$16,000	$60,000
Advances:					
From A	....	....	....	110,000	....
From B	95,000	....	60,000	....	....
Capital stock:					
Preferred — par value $100	1,000,000	....	....	100,000	....
Common — par value $100	1,000,000	700,000	200,000	50,000	100,000
Surplus:					
Balances, Dec. 31, 1929	880,000	100,000	18,000	....	....
Profits — 1930	530,000	225,000	2,000	10,000	*20,000
Profits — 1931	390,000	375,000	5,000	*80,000	50,000

*Red.

	A	B	C	D	E
Dividends paid, preferred:					
1930	*$70,000	....	....	*$6,000	....
1931	*70,000	....	....	....	....
Dividends paid, common:					
March 15, 1930	....	*$20,000	....	....	....
December 15, 1930	*300,000	*70,000	....	....	....
December 15, 1931	*200,000	*70,000	....	....	*$15,000
	$3,790,000	$1,660,000	$440,000	$200,000	$175,000

* Red.

No. 2 (28 points):

The Endicott Company commenced operations January 1, 1931, manufacturing one type of commodity of a standard pattern.

At the end of the year, the bookkeeper prepared and submitted the following statements:

Exhibit A

Statement of profits

Sales, net—3,500 articles at $40	$140,000
Deduct: Cost of 3,500 articles at $28 (exhibit B)	105,000
Net profit	$35,000

Exhibit B

Statement of cost of manufacture and cost of sales

Total expense (exhibit C)			$140,000	
Total articles produced	5,000			
Articles in process	500			
Cost per article		$28		
Cost of 5,000 articles at $28				$140,000
Inventory of 1,000 articles at $28.			$28,000	
" " 500 " " 14.			7,000	35,000
Cost of sales—3,500 articles at $30 (exhibit A)				$105,000

Exhibit C

Expenses

Raw material purchases	$40,000	
Less: Inventory—cost, plus freight	3,000	$37,000
Salaries and wages		58,000
Freight		4,600
Insurance—factory		2,300
Taxes— "		1,300
Advertising		4,594
Printing and stationery		2,200
Rent of office		2,400
Interest paid		1,800
General expenses		10,505
Repairs—factory and machinery		2,801
Power, light and heat—factory		7,100
Sundry expenses— "		3,000
Supplies— "		900
Experimental work		400
Stable and auto expense—factory		1,100
Total (exhibit B)		$140,000

The accuracy of these statements is questioned, and you are called upon to check them and to prepare a statement in statistical form showing sales, cost of goods sold, gross profit on sales, selling expenses, net profit on sales, general and administrative expenses, net profit on operations, financial charges and net income for the year.

Your investigation discloses the following:

Salaries and wages account—

Officers' salaries	$17,400
Salesmen's salaries and commission	16,400

Labor—direct	$16,500
" indirect	7,700
Total	$58,000

Accrued wages, not included in above—

Labor—direct	$1,900
" indirect	600
Total	$2,500

Freight account—

Inward	$2,800
Outward	1,800
Total	$4,600

Insurance account—
Unexpired, $1,700.

Printing and stationery—
On hand, $850.

Interest paid—
$500 applies to 1932.

General expenses—
$1,300 applies to 1932.

Upon consulting with the president, it was decided that the charge for depreciation on the factory building should be 4 per cent. on $52,000, and on machinery 10 per cent. on $16,000, and that provision for bad debts should be $2,100.

The capital stock outstanding was shown to be $275,000 on December 31, 1931.

No. 3 (18 points):

The firm of A, B & C were dealers in securities for their own account and others. On November 30, 1931, the partnership was dissolved because C, whose only capital contribution was his stock-exchange seat, desired to withdraw.

A & B formed a new partnership, taking over all assets and liabilities of the firm, except the stock exchange seat and the goodwill. (The latter was considered worthless.)

Profits and losses were shared in the ratio of 60, 25 and 15 by A, B and C respectively.

In addition to the trial balance given herewith, which reflects all routine adjustments and accruals, the following information was gathered, as of November 30, 1931:

Customers' free credit balances	$202,295
Market value of customers' securities short	36,752
" " " firm " "	29,649
" " " " " long	1,009,479

Trial balance November 30, 1931

Corn Exchange bank	$63,215	
National City bank		$750,000
Failed to receive		185,483
Stock-exchange seat	350,000	
Goodwill	250,000	
Profit on syndicate transactions		215,932
Loss on joint accounts	79,290	
Partners' salaries	51,583	
Interest received		4,592
Dividends received		21,138

Stock Clearing Corporation	$10,000	
Failed to deliver	148,660	
Accrued interest		$2,265
Interest paid	68,232	
Interest on partner's capital	42,880	
Salesmen, office and general	255,330	
Customers' ledgers	660,313	228,980
Petty cash	852	
Brokerage	7,543	
Commissions		80,533
Firm securities long	1,458,664	
" " short		16,429
Bank of America		270,000
Revenue stamps	565	
Commissions receivable	4,843	
" payable		7,556
Accrued income—syndicates	5,500	
" expense— "		201,677
Capital accounts:		
A		800,000
B		350,000
C		350,000
Drawing accounts:		
A	12,192	
B		16,147
C	31,070	
	$3,500,732	$3,500,732

From the foregoing data, prepare the opening balance-sheet of the new partnership of A & B, as at December 1, 1931.

No. 4 (18 points):

(a) At December 31, 1930, the Rightform Manufacturing Company was carrying, as current assets, certain temporary investments (at cost), whose respective market values you find to be approximately as follows:

	Cost	Approximate market values
Common stocks:		
400 shares Southern Pacific..........	$45,320	$37,500
220 " National Biscuit..........	18,600	17,080
50 " Western Union...........	9,415	6,675
U. S. Liberty Loan, 4¼'s of 1933–1938..	21,950	21,150
	$95,285	$82,405

State clearly three methods (in order of preference from the viewpoint of conservatism) of treating these investments in the annual accounts.

(b) The Satisfaction Tailoring Corporation has funds on deposit in several banks, two of which closed during the latter part of 1931 and, at the date of your examination, have not reopened.

What is the conservative way to state these frozen deposits on the corporation's balance-sheet at December 31, 1931?

(c) The Interstate Holding Company owns capital stock of three subsidiary companies—A, B and C—amounting to 95, 90 and 60 per cent. respectively, of the total outstanding stock of each. In preparing statements of the holding company, for the guidance of its directors in deciding upon the declaration or omission of dividends, what cognizance, if any, would you take of the following conditions?

(1) The book value of A company's stock is less than that at which it is carried by the holding company, due to heavy losses incurred in the current and preceding years as a result of inefficient management.

(2) The book value of B company's stock is substantially less than that at which it is carried by the holding company, as a direct result of the subsidiary's having declared and paid dividends during the current year in excess of profits.

(3) C company's stock, which is carried on the books of the holding company at an average cost in the open market of $84 per share, is quoted on the New York stock exchange at $10.50 at the balance-sheet date. Investigation shows that this shrinkage is directly attributable to two factors: (a) adverse conditions in the industry, and (b) general financial conditions and other causes entirely unrelated to the business.

State briefly what your treatment of the foregoing factors would be in preparing a balance-sheet for the holding company.

No. 5 (18 points):

The revenue act of 1932 provides for a tax of 13¾ per cent. of the amount of the net income of every corporation. If a consolidated return is filed, the rate is 14½ per cent. These rates apply to the entire amount of net income, as corporations are no longer allowed a specific credit. A net loss of a corporation may be deducted in the succeeding taxable year.

Income-tax returns for the year 1932 are due on or before March 15, 1933.

A parent company owns all the outstanding common stocks of 62 operating companies, with the exception of qualifying directors' shares. The books of the parent company and of the subsidiary companies are audited annually by public accountants, and reports are submitted for each company, as well as a consolidated balance-sheet and a consolidated income and profit-and-loss statement.

The parent company maintains a tax department, and the income-tax returns are prepared by this department, but the public accountants are retained to give advice with respect to federal tax matters.

(a) In December, 1932, you are asked for your opinion as to whether a consolidated return should be filed or whether separate returns should be filed for each company. In giving your opinion, state briefly the factors you would take into consideration, with such qualifications as you deem necessary.

(b) You are also requested to confer with the company's tax department and suggest, in a general manner, methods whereby the return, or returns, may be prepared with a minimum of expense and with a consistent treatment of taxable items of income and deductions of all companies.

Do not submit forms: give only an outline of the procedure to be followed in the preparation of the return or returns.

Examinations of May, 1933

Auditing

MAY 11, 1933, 9 A. M. TO 12:30 P. M.

Answer all the following questions.

No. 1 (10 points):

State what you understand to be the scope of the following:

(a) Balance-sheet audit
(b) Complete audit
(c) Continuous audit
(d) Special audit

No. 2 (10 points):

The E. Z. Corporation issued $100,000 of preferred stock with an obligation to set aside a certain percentage of its annual profits as a reserve for the final redemption of the stock at par, a corresponding fund being accumulated in actual cash. It is further provided that the corporation may use this cash to repurchase its preferred stock in the market, carrying it as treasury stock until redeemed. Such redemption may take place at any time on due notice to the holders.

In the course of time the corporation has set up such a reserve and cash fund to the amount of $50,000. In 1932, owing to the depression in the stock market, it was enabled to buy in the entire issue at an average cost of 10 per cent., or $10,000. Thereupon, after giving "due notice," it redeemed the entire issue, and its balance-sheet now shows cash in the fund of $40,000 and an increase in the surplus of $140,000.

At the annual meeting, which you attend as auditor, you are asked if this additional surplus is available for an extra dividend on the common stock.

What would you reply? Give your reasons.

No. 3 (10 points):

Why should an auditor insist upon examining all insurance policies, life, fire, indemnity, and compensation, in the course of his work?

No. 4 (10 points):

What would you consider a satisfactory voucher for:

(a) Payrolls in a large manufacturing business,
(b) Purchase of a stock-exchange security,
(c) Investment in a mortgage,
(d) Investment in, and the current value of, building-and-loan shares?

No 5 (10 points):

The A. B. Corporation has ten thousand hands employed in some twenty departments. Its payrolls have always been made up by departments in standard form, and hitherto it has had little trouble in ascertaining each employee's total compensation, as changes from one department to another were very rare. In 1932 it adopted a "spread-the-work" plan which involved not only laying off men for short periods but also switching hundreds of them from one department to another as occasion demanded.

Entering on your annual audit engagement February 1, 1933, you find the entire clerical staff working frantically to make out information returns, the number being greatly increased by the lowering of personal exemptions under the federal income-tax act of 1932. Wages are paid weekly on the hourly basis, so the correct amounts to be returned can be obtained only by tracing each man's time through every departmental payroll.

You are asked to suggest some method by which the data for these information returns may be easily and accurately compiled for the future, without disorganizing departmental cost accounting.

What would you suggest?

No. 6 (10 points):

The X. Y. Corporation becomes insolvent and you are appointed receiver. State in detail the system of accounting you will adopt, and the form of your final report to the court.

No. 7 (10 points):

State in detail how you would audit, verify and classify on the balance-sheet securities in which the surplus funds of a corporation are invested.

No. 8 (10 points):

Give four principal examples of contingent liabilities, and state how you would proceed to discover them.

No. 9 (10 points):

A merchandising corporation shows in its profits for the year under audit a large amount of anticipated cash discounts on its accounts payable. Discuss the pros and cons of this practice.

No. 10 (10 points):

The X. Y. Corporation shows on its balance-sheet, among its assets, the following items:

Notes receivable	$300,000	
Accounts receivable	200,000	
	$500,000	
Less reserves	150,000	
		$350,000

What criticisms have you to offer? State the principle involved.

Accounting Theory and Practice—Part I

MAY 11, 1933, 1:30 P. M. TO 6:30 P. M.

The candidate must answer the first three questions and one other question.

No. 1 (37 points):

You are engaged by the chairman of the reorganization committee of the S Y Manufacturing Company to make an examination of the books of account and records of the company for the period from January 1, 1926, to June 30, 1932, and to render a report. It is specifically requested by the chairman that your report contain an application-of-funds statement embodying a complete summary of securities and cash transactions during the period.

Your examination discloses the following facts:

The company was organized January 1, 1926, to bring together, under the control of one corporate management, five competing concerns manufacturing automobile accessories, with plants located in distant large cities.

The new corporation took over the fixed assets of all the other companies (gross value $8,000,000 less

$3,000,000 depreciation), issuing cash and securities therefor, as set forth in the following summary:

	Cash and securities issued for net assets acquired				
Name of plant	First mortgage 6% gold bonds at par	7% preferred stock at par	No-par common stock at stated value	Cash	Totals
A	$800,000	....	....	$200,000	$1,000,000
B	....	$300,000	....	500,000	800,000
C	800,000	....	$400,000	....	1,200,000
D	....	....	....	400,000	400,000
E	....	....	1,600,000	....	1,600,000
Totals	$1,600,000	$300,000	$2,000,000	$1,100,000	$5,000,000

In order to provide cash for working capital and to pay off bank loans of $1,000,000, releasing collateral set up at a like book value, additional securities were issued as follows:

$900,000 first mortgage 6 per cent. gold bonds at 90
$700,000 7 per cent. preferred stock at par
100,000 shares, no-par common stock, at $15 per share.

The capitalization of the new company was as follows:

First mortgage 6 per cent. sinking fund gold bonds...	$2,500,000
7 per cent. preferred stock, par value $100 per share..	$2,500,000
No-par common stock, stated value $10 per share....	350,000 shares

Further information, obtained in the course of your examination, is set forth in the tabulation on the following page.

As of January 1, 1928, the corporation issued and sold 5,000 shares of its 7 per cent. preferred stock at par. As of January 1, 1929, it issued and sold 5,000 shares of its 7 per cent. preferred stock at par and 5,000 shares of its no-par common stock at $25 per share, in order to provide additional working capital and for other corporate purposes.

Particulars	1926	1927	1928	1929	1930	1931	Six months ended June 30, 1932	Totals
Net profits transferred to surplus	$400,000	$300,000	$700,000	$948,000	$238,000	$700,000*	$600,000*	$1,286,000
Surplus credits — profits on bonds retired	....	....	....	2,000	12,000	50,000	....	64,000
Dividends declared —								
Preferred	70,000	70,000	105,000	140,000	140,000	140,000	....	665,000
Common	225,000	225,000	450,000	610,000	450,000	....	....	1,960,000
Additions to property (net)	200,000	400,000	500,000	1,000,000	400,000	100,000	25,000	2,625,000
Provisions for depreciation	330,000	350,000	370,000	420,000	480,000	505,000	255,000	2,710,000
Book value of property retired, charged to depreciation reserve	350,000	300,000	250,000	700,000	300,000	300,000	125,000	2,325,000
Expenditures for renewals, charged to depreciation reserve	....	....	....	30,000	20,000	....	....	50,000
Salvage recoveries, credited to depreciation reserve	10,000	20,000	5,000	25,000	15,000	10,000	....	85,000
Bonds retired through sinking fund (a) —								
Principal amount	....	....	100,000	100,000	100,000	100,000	....	400,000
Cost	....	....	100,000	98,000	88,000	50,000	....	336,000
Sales of securities carried as permanent investments (b) —								
Book value	....	....	....	200,000	500,000	300,000	....	1,000,000
Losses charged to profit-and-loss account	....	....	....	100,000	300,000	200,000	....	600,000

* Denotes red figures.

(a) Sinking-fund requirement first effective for the year 1928 and company defaulted on 1932 requirement.

(b) Acquired from predecessor companies at date of organization of corporation.

Upon the basis of your examination of the company's accounts, you have prepared the following balance-sheet as of June 30, 1932:

THE S Y MANUFACTURING COMPANY
Balance-sheet, June 30, 1932

Assets

Current:		
Cash	$22,160	
Notes receivable	150,000	
Accounts receivable	100,000	
Inventories	425,000	$697,160
Prepaid expenses		25,000
Fixed:		
Land and property	$10,625,000	
Less: reserves for depreciation	3,420,000	7,205,000
Unamortized bond discount		42,840
		$7,970,000

Liabilities and net worth

Current:		
Bank loans	$950,000	
Other notes payable	250,000	
Accounts payable	230,000	
Accruals	90,000	$1,520,000
First-mortgage 6 per cent. sinking-fund gold bonds, maturing January 1, 1941 (a)		2,100,000
Net worth:		
Capital stock—		
Preferred 7 per cent. stock, authorized 25,000 shares, par value $100		

(a) Sinking fund payment of $100,000 due May 1, 1932, has not been paid.

each, issued and outstanding 20,000 shares	$2,000,000	
Common stock, authorized 350,000 shares no par value, stated value $10 each, issued and outstanding 305,000 shares	3,050,000	
	$5,050,000	
Paid-in surplus—excess of sale price of common stock over stated value thereof	575,000	
Earned surplus.......................	1,275,000*	$4,350,000
		$7,970,000

* Denotes red figures.

No. 2 (32 points):

In order to obtain a controlled source of crude oil to augment its own small production, the X Refining Corporation purchased the entire outstanding capital stock of the K O Producing Company. The latter company had developed several prolific wells in a pool area, and the owners were looking for a market for the oil. To finance the purchase of the subsidiary, the refining corporation sold $600,000 of 7 per cent. preferred stock and paid cash for the capital stock of the producing company.

At December 31, 1930, you are engaged to submit a report covering the operations for the year 1930. On the basis of information furnished herewith, prepare

(1) Consolidating balance-sheet as at December 31, 1930.

(2) Consolidating profit-and-loss statement for the year 1930.

(3) Consolidated surplus account for the year 1930.

Trial-balances (per books), December 31, 1930

	X Refining Corp.	K O Producing Company
Asset accounts:		
Cash	$110,000	$24,392
Accounts receivable	125,370	42,600
Inventories	75,640	5,762
Refinery and other property (cost)	1,007,391	
Oil property—		
Lease cost		1,000
Development expense		144,328
Equipment on lease		25,541
Other assets	32,000	31,000
Investment in K O capital stock	719,500	
	$2,069,901	$274,623
Liability accounts:		
Notes payable—banks	$150,000	
Accounts payable	113,689	$10,705
Accrued items	15,104	2,827
Reserves for depletion and depreciation	202,321	
Preferred stock—7 per cent	600,000	
Common stock—		
80,000 shares of $10 each	800,000	
10,000 shares of no par value		100,000
Surplus balance	188,787	161,091
	$2,069,901	$274,623

Investment account in K O stock

Shares bought:			
December 10, 1929	4,900	@ $75	$367,500
December 28, 1929	1,000	@ 65	65,000
January 15, 1930	4,100	@ 70	287,000
	10,000		$719,500

For practical purposes, the date of acquisition was December 31, 1929, and may be so considered in this problem.

X REFINING CORPORATION

Profit-and-loss account (per books)

	Year 1929	Year 1930
Operating revenue	$932,609	$865,392
Operating and general expenses	765,503	775,255
	$167,106	$90,137
Depreciation and depletion	79,886	82,401
Net operating income	$87,220	$7,736
Dividends received on K O stock	24,500	250,000
Net profit	$111,720	$257,736
Dividends paid on preferred stock		$42,000
Dividends paid on common stock	$80,000	120,000
	$80,000	$162,000
Net revenue—to surplus	$31,720	$95,736
Opening surplus	61,331	93,051
Closing surplus	$93,051	$188,787

K O PRODUCING COMPANY

Profit-and-loss account (per books)

(Operations commenced January, 1928)

	Year 1928	Year 1929	Year 1930
Barrels of oil produced	101,330	398,742	528,067

Oil sales	$152,309	$477,822	$573,112
Operating and general expenses	136,103	271,597	284,452
	$16,206	$206,225	$288,660
Provision for depletion			
Net income	$16,206	$206,225	$288,660
Dividends paid—June 15th		$50,000	$100,000
Dividends paid—December 15th		50,000	150,000
		$100,000	$250,000
Net revenue—to surplus	$16,206	$106,225	$38,660
Opening surplus		16,206	122,431
Closing surplus	$16,206	$122,431	$161,091

General Information and Remarks

The oil reserves (recoverable oil underground) of the K O Producing Company were estimated, by reliable geologists, to be 1,407,600 bbls. at December 31, 1930.

No depletion has ever been provided in the accounts of the K O Producing Company.

For the sake of simplification, assume that no capital additions have been made in the period under audit.

Inter-company sales, during 1930, amounted to $373,408. Inter-company profit remaining in inventories is nominal and may be ignored.

Disregard federal-income-tax features.

No. 3 (17 points):

From the following data submit, in detail and in total, the value, at cost, of the closing inventory. If there is any inconsistency with regard to the selling prices of the several sizes, state your explanation.

During a certain period, a plate-glass factory cast and rolled about 850,000 square feet of glass. The product, after cutting up in order to eliminate defects, was priced for sale as follows:

Size	No.	1	28	cents	per	square	foot
"	"	2	24	"	"	"	"
"	"	3	22	"	"	"	"
"	"	4	20	"	"	"	"
"	"	5	14	"	"	"	"
"	"	6	5	"	"	"	"

Any product below No. 6 was returned to process and remelted.

As may be seen, the selling price for a given quality varied with the size, the largest perfect sheets selling for the highest price per square foot.

The total cost of materials, manufacture, grinding, polishing, cutting and sorting, including factory expense, was $120,807.

The inventories—in square feet—were:

	Opening	Closing
Size No. 1....................	10,000	12,860
" " 2....................		11,000
" " 3....................	10,000	23,000
" " 4....................		6,000
" " 5....................		
" " 6....................		2,000

The sales—at list selling prices—were:

Size No. 1	$30,240
" " 2	36,480
" " 3	35,376
" " 4	21,100
" " 5	9,030
" " 6	2,300

No. 4 (14 points):

From the following data, prepare entries for the corporation's books to record all exchange transactions, the exchange position, and profits realized. Show, also, what the result would have been had the exchange risk not been covered.

A United States corporation, owning the entire capital stock of a foreign company, sells its raw material to this company at cost. From this raw material the foreign company manufactures a certain product which it sells exclusively in its own country. It pays for the raw material bought, and remits the net profits as soon as they are realized in cash.

The unit of this foreign currency is the crown, worth sixty cents at par of exchange.

The rate of exchange declining, the customary measures are taken by the U. S. corporation to guard against exchange losses. These measures consist, principally, of selling forward the foreign currency to be collected. For this reason and purpose, the company's costs and expenses, as well as the proceeds from its sales, must necessarily be determined as nearly as possible in advance.

Crowns are freely bought and sold in the U. S., there being no restriction by the foreign government on the transfer of domestic funds to other countries.

On October 1st, when the crown was selling at 30, the U. S. corporation shipped raw material which cost $30,000 and billed the foreign company for the equivalent of 100,000 crowns, payable December 30th.

It was estimated that all manufacturing, selling, administration and other expenses applicable to this venture would be 120,000 crowns and that the product would be all sold by December 30th for 250,000 crowns. The estimate proved to be correct with one exception, viz:—the goods were actually sold and delivered by December 30th for 255,000 crowns, spot cash, f. o. b. factory.

The rate of exchange had, in the meantime, fallen to 20.

No. 5 (14 points):

An excerpt from the certificate of incorporation of a certain corporation reads as follows:

"So long as five thousand (5,000) or more shares of $7 cumulative preferred stock shall be outstanding the company shall not pay or declare any dividends in cash or property on any of its outstanding shares (exclusive of the cumulative dividends on outstanding shares of $7 cumulative preferred stock) unless the company shall have, out of its net profits or out of its net assets in excess of its capital, purchased and canceled or redeemed an aggregate number of its $7 cumulative preferred stock equal to the sum of the number of shares hereinafter designated for such purchase or redemption in respect of the calendar year in which such dividend payment is made and also in respect of each previous calendar year subsequent to the calendar year 1927. The number of shares of $7 cumulative preferred stock designated for purchase or redemption in respect of each calendar year for the purposes of the foregoing calculation shall be one-half of that number of shares arrived at by dividing the total number of shares of $7 cumulative preferred stock outstanding on the first day of January of such calendar year by the number of full calendar years which will elapse between the first day of January (such day being included) of the calendar year in respect of which such determination is made and January 1, 1943."

There were 10,000 shares of preferred stock outstanding at January 1, 1928. No shares were subsequently sold and the company acquired preferred stock as follows:

In the year 1929	750 shares
" " " 1930	713 "
" " " 1931	526 "

How many shares of preferred stock will have to be acquired in 1932 and in 1933 to permit the company to pay a dividend in each of those years on its common stock?

Submit your answer in tabular form.

Commercial Law

MAY 12, 1933, 9 A. M. TO 12:30 P. M.

An answer which does not state reasons will be considered incomplete. Whenever practicable, give answer first and then state reasons.

Group I

Answer all questions in this group.

No. 1 (10 points):

State in each of the following cases whether or not Culver is legally bound by his promise and state the principles of law on which your answer is based:

(a) Hawkins, upon reaching the age of 65 years, retired from the employ of Culver and immediately thereafter Culver promised to pay Hawkins $100 each month as long as Hawkins lived. Culver had no established pension plan and at no time prior to his retirement had Hawkins expected or had any reason to expect a pension. Culver made the payments for four years but then discontinued them although Hawkins was still alive.

(b) Culver signed a subscription list by which he promised to give $100 to the Central Church toward the cost of a new organ. Other subscribers signed before and after him. The Central Church purchased the organ but Culver refused to pay the $100.

No. 2 (10 points):

The payee of a note, before its maturity, wrote on the back of it: "I hereby assign all my right and interest in this note to Richard Fay in full. (Signed) Harry C. Witte." The maker failed to pay the note at its maturity and Fay sued Witte as an endorser. Witte defended on the ground that his writing on the back of the note was a qualified endorsement and that he was not liable as an endorser. For whom should judgment be rendered?

No. 3 (10 points):

Laufer sold furniture to Burghard on a conditional sales contract for the sum of $515.39. The furniture was delivered and instalments were collected until the balance due on the contract was $343. Thereupon Laufer lawfully retook possession of the furniture and sold it. Must Laufer account to Burghard for any portion of the proceeds of the re-sale,

(a) if the net proceeds amounted to $400?
(b) if the net proceeds amounted to $200?

No. 4 (10 points):

A certificate of stock for 100 shares of the capital stock of the Bond & Share Company, issued to Lovett & Co., was endorsed by Lovett & Co. in blank and then sold for value to Whitestone & Co. who did not fill in their firm name or otherwise alter the certificate. Thereafter it was stolen from Whitestone & Co. The thief erased the name of Lovett & Co. as the stockholder and their signature as endorser, inserted the fictitious name of Adolph Zitman as stockholder, wrote Zitman's name as endorser, and pledged the certificate with Brown & Co., who received it for value in good faith and without notice or knowledge of the theft or alteration. Does the loss fall upon Whitestone & Co. or upon Brown & Co.?

No. 5 (10 points):

Hoven sold a horse to Turner, to be paid for upon delivery at Turner's residence. Hoven instructed Turner to pay Hoven's agent who would deliver the horse. Upon delivery, Turner gave the agent a cheque drawn to the order of Hoven. The agent endorsed Hoven's name on the cheque and Turner, at the agent's request, guaranteed the endorsement. The agent cashed the cheque and disappeared. Does the loss fall upon Hoven, upon Turner, or upon the bank at which the agent cashed the cheque?

Group II

Answer any five questions in this group. No credit will be given for additional answers, and if any are submitted only the first five will be considered.

No. 6 (10 points):

On August 1, 1932, an ice company by a valid contract sold 7,000 tons of ice to Whitney, who agreed to pay for and remove it by November 1, 1932. On September 3, 1932, Whitney, who had paid no part of the purchase price, notified the ice company that he would not take the ice. What remedies has the ice company?

No. 7 (10 points):

Ingle gave a cheque for $142 drawn on the First National Bank of the town of X to Case, who received it on the morning of November 19, 1930. Case sent his clerk to the First National Bank, on which a run had started at 9 a. m. The clerk took his place in line, which he held until 1 p. m. when he left and went to lunch. Upon his return he took his place at the end of the line, but the bank stopped paying at 2 p. m., before the clerk had reached the paying teller's window, and the bank did not re-open thereafter. Other persons who took places in the line after the clerk had joined it in the morning had their cheques cashed. Ingle had sufficient funds in the bank to meet all cheques drawn by him. Can Case recover in an action against Ingle?

No. 8 (10 points):

Danver was asked by Reid to become a co-surety with Taylor for an obligation owed by Reid to Pawling. Reid had prepared a written guaranty in the body of which the names of Danver and Taylor as sureties appeared. Danver signed this guaranty upon the express condition that Reid would procure Taylor's signature before delivery to Pawling. Reid ignored this condition and gave the written guaranty to Pawling without Taylor's signature. Can Pawling collect from Danver upon Reid's default in the payment of his obligation to Pawling?

No. 9 (10 points):

The Jefferson Plan Corporation was a Delaware corporation having its executive office in Philadelphia.

Pa. One of its vice-presidents was served with a summons in Trenton, N. J. The corporation had not procured a permit to do business in New Jersey. It appeared that the vice-president who was served with the summons had an office in Trenton in which he devoted his time to research work on matters affecting the Jefferson Plan Corporation, to the editing of printed literature for that corporation, and to the training of employees for it. Do these facts constitute doing business within New Jersey to such an extent as to give the courts of that state jurisdiction of the Jefferson Plan Corporation?

No. 10 (10 points):

Anthony held a life-insurance policy to which was attached a supplemental contract providing double indemnity for death caused by external violent and accidental means, for which he paid an additional premium. By the terms of the policy this supplemental contract could be discontinued "upon request of the insured and the presentation of the policy to the company for cancellation of this provision." The policy provided also that no person except certain officers at the company's home office was authorized to modify or waive any of the terms of the policy. On March 20, 1930, the company's local agent received from Anthony and mailed to the company's home office in another city the policy and Anthony's written request for the cancellation of the supplemental contract. On that evening Anthony met with an external and violent accident which caused his death at 1 a. m. on March 21,

1930. The policy and request for cancellation were received by the company at 8:30 a. m. on March 21, 1930. Can the company be held for double indemnity?

No. 11 (10 points):

Zindle, a jeweler, gave Mrs. Chapman, a prospective customer, a diamond brooch of the retail value of $5,200 to wear while she was deciding whether or not to purchase it. Mrs. Chapman was accustomed to wearing expensive jewelry, and at all times when she wore this brooch she wore other expensive pieces of jewelry of her own. To all of the jewelry she gave what women of her social standing regarded as reasonable care. Nevertheless, the brooch was lost or stolen. Must she pay for it?

No. 12 (10 points):

The Falk Company purchased the business of the Kissel Company, taking over its assets and assuming its liabilities. Among those liabilities was one to the state of Wisconsin for income taxes for the year ended on the date of purchase. The Falk Company paid those Wisconsin income taxes in the year following. Can it lawfully deduct the amount of them in computing its federal income tax for the year in which they were paid?

Accounting Theory and Practice—Part II

MAY 12, 1933, 1:30 P. M. TO 6:30 P. M.

Answer only four *questions.*

The candidate must answer any two *of the first three questions, No. 4, and No. 5* or *6.*

No. 1 (27 points):

Coal Distributors, Inc., closed its books for the fiscal year ended November 30, 1932. On March 31, 1933, it was declared bankrupt.

You are engaged by the trustee to make an investigation of the transactions of the company between the dates specified and to render a report.

From the following data

(a) Prepare adjusted balance-sheets in columnar form.

(b) State the matters disclosed by your investigation which you would include in your report to the trustee, giving your reasons for considering them important.

The assets and liabilities, as shown by the books, were as follows:

	November 30, 1932		March 31, 1933	
Accounts payable......		$118,000		$140,000
Accounts receivable ..	$260,000		$292,000	
Reserve for bad debts.		7,300		7,300
Cash in bank.........	2,200		1,700	

	November 30, 1932		March 31, 1933	
Mineral rights........	$8,600		$8,600	
Notes payable—bank..		$38,600		$48,300
Office equipment	5,200		5,200	
Reserve for depreciation		2,100		2,100
Trade acceptances received	19,000		15,000	
Trade acceptances discounted		19,000		15,000
Trade acceptances issued		51,000		62,000
Capital stock		50,000		50,000
Surplus		9,000	2,200	
	$295,000	$295,000	$324,700	$324,700

In the course of your investigation the following information is obtained:

Cash in bank was applied by the depository as a partial offset to the notes. Cheques outstanding, at the date of application, March 31, 1933, totaled $5,300. Accounts receivable consisted of the following:

	November 30, 1932		March 31, 1933	
Debtor	Amount owing	Considered worthless	Amount owing	Considered worthless
Ruby Coal Company..	$10,600	$10,600	$17,300	$17,300
Retail Coals, Inc.....	63,500	22,000	58,000	24,000
White Heat Company.	52,700	46,000	63,800	63,800
All other customers...	113,700	15,000	134,800	19,000
Officers and employees	19,500	17,400	18,100	18,000
	$260,000	$111,000	$292,000	$142,100

In the files you find conclusive evidence that the worthlessness of the accounts, as indicated, was well known to the officers on or before the respective dates.

Trade acceptances discounted were the direct obligations of Ruby Coal Company.

Mineral rights represented the cost, in 1920, of rights to extract certain subsurface deposits. Coal was mined on this property until about July 1, 1924, when operations were discontinued.

Trade acceptances, and accounts payable, consisted of the following:

Creditor	November 30, 1932	March 31, 1933
Greater Mines, Inc.	$45,000	$3,500
Deep Valley Coal Co.	72,500	2,300
White Haven Mining Co.	4,100	94,500
Pocahontas & Co.	1,300	57,000
All others	46,100	44,700
	$169,000	$202,000

Prior to November 30, 1932, only small and intermittent purchases had been made from White Haven Mining Company and Pocahontas & Co. Greater Mines, Inc., and Deep Valley Coal Company refused further credit to Coal Distributors, Inc. on or about November 30, 1932 (as evidenced by letters on file). The liabilities to these companies were discharged largely by delivery of train-loads of coal directly to customers of those companies (public utilities and coaling docks), such coal being shipped from the mines of White Haven Mining Company and Pocahontas & Co.

No. 2 (27 points):

Company A is a holding company with subsidiary companies B, C. and D. From the information submitted, prepare a statement showing the earnings per share of all the companies applicable to that part of the common capital stock of Company A which is held by the public.

The income and surplus accounts of the several companies, for the year ended December 31, 1932, were as follows:

	Companies			
	A	B	C	D
Net sales		$2,000,000	$300,000	$120,000
Cost of sales		630,000	160,000	42,000
Gross profit		$1,370,000	$140,000	$ 78,000
Selling and delivery expenses		512,000	42,000	27,000
Selling profit		$ 858,000	$ 98,000	$ 51,000
Administrative and general expenses	$ 4,400	320,000	40,000	22,000
Profit from operations	$ 4,400*	$ 538,000	$ 58,000	$ 29,000

* Loss or deficit.

	Companies			
Income credits:	A	B	C	D
Dividends from affiliated companies.....	$527,600	$ 36,350		
Income from investments		60,000	$ 2,500	$ 1,000
Discount on purchases		6,200	2,600	1,800
Interest on loan to Company. A.......		1,800		
	$527,600	$ 104,350	$ 5,100	$ 2,800
Gross income..........	$523,200	$ 642,350	$ 63,100	$ 31,800
Income charges:				
Discount on sales....		$ 24,800	$ 5,200	$ 2,200
Interest paid Company B	$ 1,800			
Bank interest and discount		3,200	400	
Federal tax on income for current year—estimated		79,800	7,900	4,100
	$ 1,800	$107,800	$ 13,500	$ 6,300
Net income.............	$521,400	$534,550	$ 49,600	$ 25,500
Dividends paid:				
On preferred stock....	$ 75,000	$100,000		
On common stock.....	375,000	400,000	$ 40,000	$ 30,000
	$450,000	$500,000	$ 40,000	$ 30,000
Surplus	$ 71,400	$ 34,550	$ 9,600	$ 4,500*

The capitalization of the companies is as follows:

	Shares issued	Number of shares owned by affiliated companies A	Number of shares owned by affiliated companies B
Company A:			
Preferred stock.............	100,000		3,000
Common stock..............	500,000		6,000
Company B:			
Preferred stock.............	25,000	24,000	
Common stock..............	50,000	49,000	
Company C—common stock....	1,000	990	
Company D— " "	1,500		1,480

* Loss or deficit.

All dividends on preferred stocks have been paid to the latest dividend dates at the full accumulative rates.

The unrealized inter-company profit in inventories was as follows:

	December 31 1931	December 31 1932
On sales of Company C to Company B....	$40,000	$44,000
On sales of Company D to Company B...	28,000	30,000
	$68,000	$74,000

It is the intention of the companies to file individual federal-income-tax returns for the year.

No. 3 (27 points):

From the following data, revise as of December 31, 1929, the machinery, depreciation reserve, surplus and income accounts for the year 1929, wherever necessary, and prepare a schedule showing loss or gain on dismantlements. State what you would advise your client to do with regard to federal taxes, giving your reasons for such advice.

The S Novelty Company was organized January 1, 1926, to take over the business (including the machinery) of three other companies. Capital stock of $1,500,000, in shares of $100 par value each, was issued, $750,000 for cash and $750,000 for the appraised value of the machinery of the three companies which were consolidated to form the S Novelty Company. No stock was issued except for cash or the machinery of the constituent companies, working capital being provided from the proceeds of the sale of stock.

The company's operations were carried on in a rented building. The annual profits and losses of the company from 1926 to 1931, as shown by the books and as returned for federal income taxes, were:

Year	Loss	Profit
1926................	$100,000	
1927................	90,000	
1928................	10,000	
1929................		$200,000
1930................		220,000
1931................		180,000

On February 28, 1932, after the books of the company had been closed for the year 1931, an internal-revenue agent visited the office to examine the records regarding the federal-income-tax return for the year 1929. As the company had shown losses up to the end of 1928, their federal-tax returns had been accepted as rendered. After the agent had been working on the books a few days, he informed the president of the company that an additional federal tax would be demanded for the year 1929, based on an additional income of $54,600, claiming that this increase was due entirely to an adjustment of depreciation. He agreed to the rate of 10 per cent. on plant and machinery and also to the use of the beginning balance in the machinery account as the base for the calculation of depreciation.

You are called upon, at this time, to advise the president of the company as to the proper course to pursue, and you are given an abstract of the machinery account from the ledger, which is as follows:

1926		Dr.	Cr.
Jan. 1	Capital stock (7,500 shares)..	$750,000	
	Cash	100,000	
	Cash		$20,000
	Depreciation		75,000
1927	Cash	150,000	
	Cash		10,000
	Depreciation		83,000
1928	Cash	200,000	
	Cash		50,000
Jan. 1	Appraisal	500 000	
	Depreciation		147,000
1929	Cash	100,000	
	Cash		10,000
	Depreciation		162,000
1930	Cash	50,000	
	Cash		15,000
	Depreciation		171,000
1931	Cash	20,000	
	Cash		5,000
	Depreciation		174,500
Dec. 31	Balance		947,500
		$1,870,000	$1,870,000

You are shown, also, a copy of the appraisal at January 1, 1926, on the basis of which the stock was issued, and a copy of another appraisal as of January 1, 1928, on the basis of which the charge of $500,000 was made to the machinery account in that year.

The bookkeeper has kept memoranda of the machinery sold or scrapped, as follows:

In the year 1926, machinery included in the appraisal of January 1, 1926, and valued at $30,000, scrapped or sold, realized $20,000, and $500 was spent in tearing it down and preparing it for shipment.

In 1927, machinery appraised at $14,000 as at January 1, 1926, was sold for $9,500 and a stamping machine bought in 1926 for $2,000 was scrapped and sold for $500. The expense of tearing down this machinery and preparing it for shipment was $300.

In 1928, the hydraulic presses, included in the appraisal of January 1, 1926, and valued at $70,000, were sold for $45,000 to make room for more modern equipment. The expense of tearing down and preparing for shipment was $750. These presses were valued at $75,000 in the appraisal of January 1, 1928.

Special machinery bought in 1926 for $10,000, which was appraised at $15,000 on January 1, 1928, was sold during 1928 because the work for which it was purchased was no longer performed by the company. The company received $5,000 from the sale, and $250 was spent in removing the machinery and shipping it to the purchaser.

In 1929, miscellaneous machinery included in the appraisal of January 1, 1926, at $15,000 and in the appraisal of January 1, 1928, at $16,000, was sold for $9,000. Preparation for shipment cost $250.

A special machine, purchased in 1927 for $2,000, was sold in 1929 for $1,000, the purchaser paying all freight and dismantlement charges.

Similar memoranda were kept for the years 1930 and 1931.

NOTE.—The figures subsequent to 1929 are given here merely for information.

No. 4 (36 points):

From the following trial balance and supplementary information, you are to prepare a balance-sheet, as at December 31, 1932, and the related profit-and-loss account for the year ended that date. Formal journal entries are unnecessary.

The balance-sheet is to be prepared for a certain creditor, who has guaranteed the payment for your services, and you are requested to make all necessary adjustments, regardless of amount, and to give effect through such adjustments to transactions, valuations or reclassifications which would affect the financial position of the company, rather than through the use of footnotes or qualifications.

GENERAL FURNITURE COMPANY

Trial balance, December 31, 1932

	Dr.	Cr.
Cash	$100,000	
Notes receivable—trade................	150,000	
Accounts receivable—trade.............	650,000	

	Dr.	Cr.
Reserve for bad debts..................		$55,000
Inventories	$750,000	
Advances and loans....................	50,000	
Investments	150,001	
Prepaid insurance and other expense....	22,550	
Cash-surrender value of life insurance policy	5,000	
Land	500,000	
Buildings	730,000	
Equipment	350,000	
Reserve for depreciation...............		195,000
Notes payable—American City State Bank		550,000
Drafts payable		5,000
Accounts payable		420,000
Accrued interest, wages, taxes, etc.....		40,000
Note payable—J. B. Lee...............		50,000
First mortgage bonds, 6 per cent. due June 1, 1938........................		500,000
Capital stock—13,000 shares of $100 par value each		1,300,000
Unissued capital stock.................	57,450	
Surplus		575,001
Sales		2,000,000
Cost of sales..........................	1,500,000	
Selling expense	400,000	
Administrative expense	150,000	
General expense	100,000	
Interest paid	32,500	
Interest received		7,500
	$5,697,501	$5,697,501

An analysis of the accounts discloses that cash is composed of

Working funds	$8,000
Balance in First National Bank (closed October 15, 1932)	1,000
Balance in First State Bank (closed December 15, 1932)	3,500
Balances in other banks	90,000
	$102,500
Deduct: Overdraft in Second State Bank account	2,500
Net cash balance—per trial-balance	$100,000

NOTE.—Make no provisions for loss on balances in closed banks.

Notes comprise $30,000 due in 1933, $35,000 due in 1934, and $85,000 due in 1935. All these notes are pledged against a bank loan.

Inventories consist of raw material and supplies to the amount of $150,000 and finished product to the amount of $600,000. Raw material and supplies are valued at the lower of cost or market, and finished product at cost as determined by the company. Upon investigation it is found that, due to low production, overhead expenses are abnormally high and that if the company's cost had been so calculated as to include an overhead rate based on normal production, the overhead included in the inventories would be reduced by $100,000.

Investments comprise

Listed bonds, at cost	$140,000
Stock of A B Lumber Co., at cost	10,000

100 shares ($100 par value each) of First National Bank stock, at the nominal value of............	$1
	$150,001

The market value of the listed bonds is found to be $120,000. There is no trading in the stock of A B Lumber Co., but from a balance-sheet of that company submitted to you, it is ascertained that the cost at which this stock is carried is not in excess of the book value thereof, as shown by the balance-sheet of the A B Lumber Co.

Advances and loans, at December 31, 1932, consist of a loan with interest paid to December 31, 1932, to Adams Chemical Co., of $50,000, against which 700 shares of the capital stock of General Furniture Co. were held as collateral. These 700 shares had a market value at December 31, 1932, of $80 per share. The loan became due December 30, 1932, and under date of January 10, 1933, the Adams Chemical Co. stated that it was unable to reduce the loan or to provide additional collateral and assented to the forfeiture of the 700 shares of collateral stock in cancellation of the indebtedness.

An examination of the advances-and-loans account discloses that the president, J. A. Stewart, had paid off a loan (carried since June 1, 1930) of $25,000 on December 27, 1932, and that on January 6, 1933, a loan of the same amount was again made to Mr. Stewart.

The company is carrying a life-insurance policy, of the face value of $100,000, on the life of the president, the cash-surrender value of which at December 31, 1932, was $5,000. This policy was pledged under the indenture securing the company's bond issue.

The American City State Bank has confirmed its loans to the company in the amount of $550,000. Collateral held by the bank consisting of bonds, notes receivable and accounts receivable, has been found to agree with the company's record, and to comprise all of its bonds and notes receivable, and $200,000 of its accounts receivable.

Drafts payable in the amount of $5,000 represent outstanding drafts of the company, used in lieu of bank cheques to avoid federal taxes, in a form approved by the company's counsel for this purpose.

The note payable in favor of J. B. Lee, vice-president of the company, has been confirmed by Mr. Lee. It is a demand note, dated June 1, 1930, bearing interest at the rate of 5 per cent. Interest on this note has been paid, or accrued, by the company to December 31, 1932.

Unissued capital stock, shown on the trial-balance in the amount of $57,450, is found to represent 400 shares of unissued stock and 200 shares of reacquired stock at a cost of $17,450. The acquisition of 700 shares of collateral, forfeited by Adams Chemical Co., has not been recorded on the books.

NOTE.—In preparing your balance-sheet, do not carry any treasury stock on the asset side thereof.

An analysis of surplus is as follows:

Undistributed profits to December 31, 1931		$405,000
Surplus arising from appraisal of properties, December 30, 1928, less depreciation thereon to December 31, 1932		150,000
Premium on sale of capital stock		30,000
Credit for plant site donated by chamber of commerce in 1920		25,000
		$610,000
Deduct:		
Write-down of inventory of new line of cabinets introduced in 1932	$25,000	
Write-down of First National Bank stock	9,999	34,999
Balance		$575,001

Commitments for the purchase of materials at December 31, 1932, aggregated $100,000, for which the market price, at that date, was $90,000.

No. 5 (10 points):

An old, established corporation, whose books have never before been audited by a public accountant, requests you to make an examination of its accounts as of December 31, 1931.

As a result of your examination, you find the following items included in the accounts:

Debits

Appreciation of land	$800,000
Appreciation of buildings	200,000
Trademarks	2,000,000
Treasury stock—5,000 shares at cost (market value, $30,000)	180,000

Credits

Reserve for depreciation on appreciation of buildings	$15,000
Capital stock, consisting of 200,000 shares of $50 each	10,000,000
Surplus balance, including net earnings plus credits arising from book valuations of trademarks, appreciation, etc., and after deduction for all dividends paid or declared	15,000

You have convinced the officers that the values set up for appreciation of land, buildings and trademarks should be eliminated and the treasury stock canceled. Since there is insufficient surplus to absorb these adjustments, it has been suggested that they be made against the stockholders' net equity and that new shares of no par value be exchanged for the present shares outstanding, on the basis of one new share for one old share.

The plan has been duly approved by the stockholders and the change in capital has been properly authorized, effective as of January 1, 1932.

You are now requested to furnish the necessary entries to record the new set up, in order to prepare and submit a balance-sheet as of March 31, 1932. In the period from December 31, 1931, to March 31, 1932, the net earnings from operations amounted to $40,000. No dividends were paid or declared. All the old shares outstanding have been exchanged for the new ones.

(1) Submit your adjusting journal entries, giving effect to the re-organization of capital, the elimination of all items of appreciation and intangibles, and the cancellation of treasury stock.

(2) Show the amount of the capital-stock account at March 31, 1932, and the manner in which the account would be stated on the balance-sheet at that date.

(3) What is the balance in the surplus account at March 31, 1932?

(4) What footnote, if any, would you place on the balance-sheet submitted as at March 31, 1932?

No. 6 (10 points):

A is the owner of a patent on a mechanical device. In order to arrange for its manufacture and sale, he enters into an agreement with B as follows:

B to advance the funds necessary to manufacture and place the patented device on the market. B's expenditures are to be returned to him out of profits before any division, after which, A and B are to share equally therein.

After a certain period of operation, you are employed to ascertain the amount due A under the contract, the records disclosing the following:

Advances by B	$50,000
Accounts receivable	80,000
Accounts payable	25,000
Sales	170,000
Cost of manufacture	80,000
Overhead	10,000
Inventory	30,000
Cash on hand	75,000

(a) Prepare a statement in the form you would render to both A and B.

(b) If there had been an expenditure of $50,000 for machinery and equipment, in addition to the items shown above, what would have been the condition, as between A and B, in conforming with the terms of the contract?

Examinations of November, 1933

Auditing

NOVEMBER 16, 1933, 9 A. M. TO 12:30 P. M.

Answer all the following questions:

No. 1 (10 points):

(a) What items in the balance-sheet of a manufacturing and trading concern would you normally classify as current assets and current liabilities?

(b) State upon what tests you would rely to determine whether items in part or in whole were properly classified under such headings.

No. 2 (10 points):

In auditing the A Corporation you find that during the year it has taken over the assets (except goodwill) and the liabilities of the B Corporation in exchange for an agreed amount of stock of the A Corporation at par. The said assets and liabilities have been merged with those of the A Corporation, and the latter's goodwill account has been increased to balance the balance-sheet after merger. You are satisfied that all values are sound.

(a) What is indicated as to the consideration paid by Corporation A?

(b) Should it be reflected in the goodwill account of A or not? Give your reasons.

(c) In what other manner might the transaction be treated on A's books?

(d) Supposing the conditions upon which your answer to (a) is based to be reversed, how would you treat the transaction?

No. 3 (5 points):

In the code of ethics of the American Institute of Accountants it is provided that no member shall advertise his professional attainments. Explain the principle underlying this rule.

No. 4 (15 points):

You are auditing the accounts of the Smith Corporation for the year 1931, and ascertain the following facts:

(1) The Smith Corporation owns a one-half interest in the Jones Corporation, which manufactures parts used by the Smith Corporation in its products.

(2) The Jones Corporation had been highly profitable up to December 31, 1928, and has accumulated five million dollars in earned surplus, but in 1931 it earned only $25,000.

(3) Up to December 31, 1930, the Jones Corporation had never paid any dividends to its stockholders, but in 1931 it declared and paid two million dollars out of its surplus.

(4) The Smith Corporation credited its dividend from the Jones Corporation to current earnings, and its profit-and-loss statement for the year 1931 shows the following composite item:

"Net earnings for the year to Dec. 31, 1931, after deducting discounts, allowances, cost of sales, depreciation, selling and administrative expenses, and after crediting discounts and miscellaneous income...........	$500,000"

(a) Would you or would you not certify this statement? Give your reasons.

(b) If not, then give two modified statements, either of which you would be willing to certify.

No. 5 (10 points):

The Dimenslot Company maintains a branch office in a distant city where the only financial transactions authorized are the collection and banking of receipts from automatic vending machines, the payment of branch payrolls and expenses, and the remittance to the factory of funds in excess of branch requirements. Monthly reports of cash receipts and disbursements are sent to the factory.

As auditor you send to your representative in the branch city twelve monthly reports covering the year under audit with instructions to audit the branch records. In due course you receive a report stating that the monthly reports are in agreement with the books and that the balance in bank has been duly confirmed by the depository. The report also states that the deposits, as shown by the bank statements, exceeded the receipts, and the cheques issued by the branch exceeded the disbursements shown by the books. Such excesses consisted of items of which a list is enclosed without comments, showing in totals the following disbursements:

Bank loans, partly renewals, finally paid in full......	$12,000.00
Cheques to employees............................	2,000.00
Accommodation purchases for employees............	2,088.99

(a) What would these three items suggest to you?

(b) What should be the contra items with respect to each?

(c) What criticism would you make of your representative's report?

(d) What further steps, if any, would you take in the matter?

No. 6 (10 points):

On March 6, 1933, you start an emergency audit of the A. B. Company and you are required to render a certified balance-sheet as of that date. You find the cash on hand to consist mainly of cheques drawn on banks all over the country in payment of accounts receivable which have been duly credited by the bookkeeper. By proclamations of the president and governors of states all the banks involved have been closed, and you have learned from confidential sources that only sound banks will be permitted to reopen. Your client's own bank is regarded as perfectly sound. Given full power by your client to use your own judgment

(a) What instructions will you give the bookkeeper?

(b) How will you treat the items of cash and accounts receivable on the balance-sheet in giving an unqualified certificate? Give your reasons.

No. 7 (10 points):

You are auditing the books of a company incorporated in the United States and of its Canadian subsidiary company for the year 1931. You find that the accounts of the subsidiary have been consolidated with those of the parent company on the basis of par of Canadian exchange throughout the year, in spite of the fact that the Canadian dollar has been below par most of the year, and was 83% of the U. S. dollar on December 31, 1931.

(a) Should any exchange gain or loss be recognized? If so, should it be reflected in the consolidated accounts?

(b) Upon what basis should the conversion of fixed assets (including the credits to the fixed-asset accounts for property retirements and the provision for depreciation) be made?

(c) Upon what basis would you convert the funded indebtedness, subject to what exception?

(d) Upon what basis would you convert an inventory of goods of the Canadian company purchased during 1930?

No. 8 (10 points):

(a) What is a "stock right," and how is it declared?

(b) Give the formula for ascertaining the theoretical value of a "right" as attaching to each old share, explaining the meaning of your symbols.

(c) Give an example in actual figures.

No. 9 (10 points):

(a) The Interstate Holding Company owns capital stock of three subsidiary companies, A, B, and C, in proportions (to the total outstanding stock of each) of 95%, 90% and 60%, respectively. In preparing statements of the holding company for the guidance of its directors in deciding upon the declaration or omission of dividends, what cognizance, if any, would you take of the following facts?

1. That the book value of A Company's stock is less than that at which it is carried by the holding company because of heavy losses incurred in the current year through inefficient management.

2. The book value of B Company's stock is substantially less than that at which it is carried by the holding company, as a direct result of the subsidiary's having declared and paid dividends during the current year in excess of profits.

3. That C Company's stock, which is carried on the holding company's books at an average cost in the open market of $84 a share, is quoted on the New York stock exchange at $10 at the balance-sheet date. Investigation shows that this shrinkage is directly attributable to two factors, (1) adverse conditions in the industry and (2) general financial conditions and other causes entirely unrelated to the business.

(b) State briefly what your treatment of the foregoing factors would be in preparing a balance-sheet for the holding company.

No. 10 (10 points):

The X Company, which owns 90% respectively of the stocks of the Y and Z Companies, submits consolidated statements showing, among other things:

Income of $9,000 dividend received by the Y Company, which actually earned $12,000 during the current year.

Net liability to minority stockholders of Z Company $9,000, which is explained to be the difference between the minority capital stock of $10,000 and a loss of $1,000 for the current year sustained by the Z Company.

If you find any error in either or both of the above items, state how it should be corrected.

Accounting Theory and Practice—Part I

NOVEMBER 16, 1933, 1:30 P. M. TO 6:30 P. M.

Answer problems 1, 2 and 3 and either problem 4 or problem 5.

No. 1. (30 points):

On the basis of the following information prepare:

1. A balance-sheet of all funds after closing the books at December 31, 1932.
2. A statement of the current surplus of the general fund for the year, showing the revenue, the expenditures and other items increasing or decreasing surplus during the year and the balance of surplus at the end of the year.
3. A statement of income and expense of the water department for the year.

The city of Dowell classifies its accounts under four different funds. The balances in the accounts of those funds on January 1, 1932, and on December 31st of the same year before closing were as follows:

General fund	January 1st	December 31st
Cash	$10,162	$21,215
1931 taxes receivable	15,676	12,429
Accounts receivable	2,325	3,545
Stores	9,641	9,533
Permanent property	3,154,695	3,154,695
1932 taxes receivable		60,838
Estimated revenue from taxes		225,000
Estimated revenue from miscellaneous sources		62,000

General fund—Continued	January 1st	December 31st
Appropriation expenditures for current purposes		$234,398
Appropriation expenditures for capital additions		8,716
Appropriation expenditures for payment of bonds.............		25,000
Appropriation encumbrances (1932)		5,842
	$3,192,499	$3,823,211
Accounts payable	$2,826	$5,626
Reserve for 1931 taxes..........	10,200	10,200
Reserve for orders and contracts.	3,286	5,842
Reserve for stores..............	10,000	10,000
Current surplus	11,492	11,603
Bonds payable	250,000	225,000
Capital surplus	2,904,695	2,929,695
1932 tax anticipation notes payable		25,000
Reserve for 1932 taxes..........		24,766
Revenue from taxes.............		222,894
Revenue from miscellaneous sources		64,325
Appropriations		276,000
Estimated budget surplus........		11,000
Sale of old equipment..........		1,260
	$3,192,499	$3,823,211

Water fund	January 1st	December 31st
Cash	$6,126	$717
Accounts receivable	7,645	5,573
Stores	13,826	12,635
Investments of replacement fund..	21,700	24,500
Permanent property	212,604	214,204
Labor and material expense......		

Water fund—Continued	January 1st	December 31st
Interest on bonds		$3,000
Depreciation charge		10,600
Accounts of prior years written off		1,097
Expended for additions to plant		12,460
	$261,901	$394,424
Accounts payable	$4,324	$4,318
Customers' deposits	1,500	1,600
Replacement fund reserve	21,700	24,500
Operating surplus	21,773	21,773
Bonds payable	60,000	40,000
Capital surplus	152,604	154,204
Services billed		146,867
Deposits lapsed		60
Interest on investments		1,102
	$261,901	$394,424

Assessment fund		
Improvement No. 50	January 1st	December 1st
Cash	$4,653	$1,844
Assessments receivable	46,829	33,414
Delinquent assessments receivable	4,826	2,010
Public benefit receivable	5,632	4,516
Interest on bonds		3,000
	$61,940	$44,784
Bonds payable	$60,000	$40,000
Surplus	1,940	1,940
Interest on assessments		2,844
	$61,940	$44,784

Improvement No. 51	January 1st	December 31st
Cash		$851
Assessments receivable		21,600
Public benefit receivable		2,400
		$24,851
Bonds payable		$24,000
Surplus		390
Interest on assessments		461
		$24,851

Trust funds	January 1st	December 31st
Cash	$3,216	$31
Investments	94,425	99,425
Premium on investments		800
Accrued interest purchased		260
Cemetery maintenance		849
Cemetery expense		2,976
Policemen's pensions paid		3,200
Firemen's pensions paid		2,400
	$97,641	$109,941
Cemetery endowment fund reserve	$60,000	$60,000
Policemen's pension fund reserve	18,691	18,691
Firemen's pension fund reserve	16,824	16,824
Cemetery maintenance fund reserve	2,126	2,126
Profit on sale of investments		600
Undistributed income		4,800
Policemen's pension fund contributions		4,160
Firemen's pension fund contributions		2,740
	$97,641	$109,941

It is the practice of the city to close out the unencumbered balance of appropriations of the general fund at the end of each year. Depreciation on the general property of the city is not entered and accrued interest on investments or on outstanding bonds is disregarded. Income and profit on trust fund investments are distributed 62% to cemetery funds, 20% to policemen's pension fund, 18% to firemen's pension fund.

The cemetery maintenance fund consists of the income from the cemetery endowment fund and is used for cemetery expense. Excess of receipts over disbursements of pension funds are closed to the reserve accounts of the respective funds at the end of each year.

Attention is directed to the following facts and conditions at the close of the year 1932:

(1) 1931 taxes in excess of the reserve against them are to be written off.

(2) Because of the increased uncertainty of 1932 tax collections the reserve on them is to be increased by fifty per cent.

(3) Invoices on all orders and contracts outstanding at beginning of year have been paid with a saving of $111, which has been credited to current surplus.

(4) The old property sold during the year was carried in the accounts at a value of $6,000.

(5) Permanent property valued at $1,820, becoming useless, was discarded during the year.

(6) Replacements of water-department equipment costing $6,200 were made from the replacement fund during the year at a cost of $7,800.

No. 2 (30 points):

On the basis of the following data prepare:

1. The surplus section of the balance-sheet that you will submit.
2. Subsidiary schedules showing the computation of the items in this surplus section.
3. The reconcilement between the $5,670,000 shown in your analysis and the amount that will be shown on your balance-sheet.

Your summarized analysis of the surplus of the Electrical Appliance Manufacturing Co. from January 1, 1908, the date of incorporation, to December 31, 1932, the date of your audit, is as follows:

Credits

Date	Description	Amount
Jan. 1, 1908 to Dec. 31, 1932	Net income carried to surplus.....	$10,000,000
Dec. 31, 1915	By debit to goodwill—as authorized by board of directors............	510,000
Jan. 1, 1920	Patents granted to Josiah Thompson on January 1, 1920; donated to the company by him as of January 1, 1920; valued by the board of directors at $340,000 as of January 1, 1920	340,000
Dec. 31, 1920	Premium on common capital stock sold	300,000
Jan. 1, 1923	Profit on sale of plant to subsidiary Company A	100,000
Jan. 1, 1923	Profit on sale of plant to subsidiary Company B	200,000

Date	Description	Amount
Jan. 1, 1926	Appreciation by appraisal:	
	Land	$200,000
	Building	500,000
	Machinery and equipment	300,000
Jan. 1, 1926	Donation to company of 5,000 shares (being the entire amount) of its preferred capital stock then outstanding	500,000
Jan. 1, 1928	Profit on sale of entire capital stock of subsidiary Company A to outside interests	175,000
Dec. 31, 1931	Discount on common capital stock reacquired and retired	200,000
Dec. 31, 1932	Discount on $500,000 face amount of the company's first-mortgage bonds reacquired and retired	100,000
Dec. 31, 1932	Reduction of capital stock from par value of $100 per share to the same number of shares with par value of $50 per share, as authorized by the stockholders at special meeting held December 21, 1932	2,000,000
Jan. 1, 1923 to Dec. 31, 1927	Undistributed earnings (i. e., net increase in earned surplus) of subsidiary Company A, taken up by debit to investment in subsidiary Company A	100,000
Jan. 1, 1923 to Dec. 31, 1932	Undistributed earnings (i. e., net increase in earned surplus) of subsidiary Company B, taken up by debit to investment in subsidiary Company B	700,000
	Total credits	$16,225,000

Debits

Date	Description	Amount
Jan. 1, 1908 to Dec. 31, 1932	Cash dividends paid on common stock	$8,000,000
Jan. 1, 1915 to Dec. 31, 1925	Cash dividends paid on preferred stock	330,000
Jan. 1, 1925 to Dec. 31, 1932	Dividends on common stock paid in common stock out of earned surplus	1,000,000
Jan. 1, 1915	Discount on sale of 5,000 shares of 6% preferred stock, par value $100 per share, at 85.................	75,000
Jan. 1, 1923	Discount of 10% on $2,000,000 of 6% First Mortgage 20 year gold bonds dated January 1, 1923...........	200,000
Dec. 31, 1932	Provide reserve for excess of cost over market value of marketable securities owned at December 31, 1932	200,000
Dec. 31, 1932	Provide reserve for obsolescence of inventory at December 31, 1932...	400,000
Dec. 31, 1932	Write off the book value of the Market Street plant abandoned as of December 31, 1932............	350,000
	Total debits	$10,555,000
	Balance—net credit............	$5,670,000

You also have in your papers the following information:

The goodwill account of $510,000 was transferred to the patent account as of January 1, 1923, by order of the board of directors.

The company provided for depreciation at the rate of 3% per annum on buildings and 10% per annum on machinery and equipment, computed on the book value. The company owns or owned the entire capital stock of two subsidiary companies, A and B.

Dividends of $400,000 were received from subsidiary Company B and credited to investment in subsidiary Company B.

A reserve for amortization of patents was provided by annual charges of 1/17th of the charges to the patent account.

The net book value of the Market Street plant at December 31, 1932, was $350,000, which was found to consist of:

	Cost	Appreciation Jan. 1,1926	Reserve for depreciation
Land	$20,000	$50,000	
Buildings	200,000	100,000	$70,000
Machinery and equipment..	300,000	50,000	300,000
Total	$520,000	$200,000	$370,000

No. 3 (20 points):

On January 1st the inventory at market values of working cattle and live stock on a plantation in the West Indies was as follows:

	Number	Unit Price	Amount
Work animals (bulls and oxen)........	1,588	$52	$82,576
Horses	16	120	1,920
Cows	274	30	8,220
Heifers	137	20	2,740
Young bulls	220	30	6,600

	Number	Unit Price	Amount
One year heifers (under two years)....	82	15	$1,230
One year bulls (under two years)......	127	20	2,540
Bull calves (under one year)..........	137	10	1,370
Heifer calves (under one year)........	114	10	1,140
Breeding bulls	6	150	900
Together	2,701		$109,236

During the year, the following changes took place:

Births—
145 bull calves
130 heifers
Deaths—
261 work animals
5 cows
4 heifers
3 bull calves
Found—
8 work animals
12 bull calves (new)
5 heifer calves (new)

Purchased (all on hand at the end of the year)—
120 work animals at $45
41 young bulls at $30
Sold—
63 work animals
4 cows
2 horses
Lost—
7 work animals

During the year 73 heifers were reclassified as cows and 175 young bulls as work animals. All of them were on hand at the end of the year.

The market values remained the same throughout the year except that work animals were worth $43 a head at the end of the year.

Prepare:

1. A columnar statement showing opening and closing inventories with number, unit price and value, together with all numerical changes during the year,

making such further adjustments as may be necessary.

2. A statement showing the amount of the opening inventory, the amounts of increases through appreciation, purchase, birth, etc., and of decreases through reduction in market value, sales and losses, thus arriving at tne amount of the closing inventory.

No. 4 (20 points):

In preparing a balance-sheet, to be used in proposed refinancing of a company engaged in the production of wine, which has maintained rather incomplete records, what amount would you use as the value of finished wine on hand, on the basis of the following data?

With respect to the inventory of wine on hand you are able to determine the following:

(1) The average cost of grape juice was $1.55 per gallon, which approximates present market.

(2) The average cost of brandy, of which 5 gallons were used per 50 gallon barrel of finished wine, was $3.75 per gallon.

(3) Filtration loss was stated to be, in the aggregate, about 4 gallons to each 50 gallons—the federal government allows 6%.

(4) The total labor cost to produce 40,000 gallons in one year was $18,000.

(5) The cost of a 50 gallon barrel was $5.50.

(6) The plant overhead was about ⅓ of the labor cost.

(7) Shrinkage averaged about 1% per annum.

(8) Carrying charges averaged about 6% per annum

(9) Of the 20,000 gallons of wine on hand, 5,000 gallons were 15 years old and 15,000 gallons were 6 years old.

Submit a work sheet and explain your reasoning.

No. 5 (20 points):

"A" opened a store on January 1, 1908, with a capital of $10,000. After deducting a reasonable salary for himself his profits, which were permitted to remain in the business, were as follows:

1908	$15,000	1913	$10,000
1909	20,000	1914	150,000
1910	30,000	1915	50,000
1911	40,000	1916	100,000
1912	60,000		

On January 1, 1917, he incorporated, and received for the net assets in the business the entire capital stock of the corporation, consisting of common stock of a total par value of $485,000.

On January 1, 1928, the company was reorganized. "A" received $1,000,000 of 6% cumulative preferred stock of $100 per share and 50,000 shares of no-par-value common stock of $485,000 stated value.

In the period from January 1, 1917, to December 31, 1927, the company had acquired for $500,000 the land and building which it occupied. On January 1, 1928, the property was appraised at $600,000 and this value was placed on the books of the reorganized company.

(a) Immediately following the reorganization on January 1, 1928, "A" sold one-half of his preferred stock for $500,000. What taxable profit or deductible loss for federal income-tax purposes did he realize from the sale?

(b) In 1930 the corporation exchanged its land and building for property in another neighborhood. The new property had a value of $600,000. Depreciation for 1928 and 1929 on the old building amounted to $5,000. What profit or loss for federal income-tax purposes was realized from this exchange?

NOTE.—Under the 1917 income-tax law goodwill was allowed as invested capital and should be considered in determining the value of the company's shares. In computing the goodwill as of any date, use invested capital and profits for the preceding five years, allow 8% return on the average capital and capitalize the balance of profit on the basis of 15%.

Commercial Law

NOVEMBER 17, 1933, 9 A. M. TO 12:30 P. M.

An answer which does not state reasons will be considered incomplete. Whenever practicable, give answer first and then state reasons.

Group I

Answer all questions in this group.

No. 1 (10 points):

Beach drew a bill of exchange on Washburn as drawee and gave it to the payee for adequate consideration. The payee personally presented it to Washburn who immediately became enraged and tore up the bill. Against whom has the payee any right of action on the bill?

No. 2 (10 points):

O'Rourke gave a mortgage on real estate to Kenyon. The mortgage note was not paid at maturity but interest was paid currently, and the mortgage continued in force as an open one without formal renewal. The property was conveyed several times until it reached Wulff. Wulff as owner made an agreement with Kenyon as mortgagee, personally assuming the mortgage debt, extending the time for the payment of it and specifying that interest was to be paid on February 19th and on August 19th of each year. Wulff then conveyed the property to Coleman, who paid the interest for several years, each payment being made from one to five days before it was due. The mortgagee upon foreclosure sought to hold Wulff for a deficiency. Wulff defended on the ground that the payment and acceptance of interest prior to its due date amounted in each instance to an extension of the mortgage without his consent and thereby relieved him as surety. Is his defense legally sound?

No. 3 (10 points):

Miller, a diamond cutter, gave a diamond on memorandum to Falk, the written memorandum expressly providing that title was to remain in Miller until Miller approved of a sale by Falk. Falk, representing that he was the owner and without showing the written memorandum, sold the diamond to Porter for cash and then disappeared without accounting to Miller. Miller now sues Porter to recover possession of the diamond. For whom should judgment be rendered?

No. 4 (10 points):

(a) How, in general, would you draw the line distinguishing interstate business from intrastate business?

(b) Are citizens of each state entitled to the privileges and immunities of citizens in the several states? (State the authority for your answer.)

(c) Is a corporation a citizen to which your answer to (b) applies?

No. 5 (10 points):

A retail storekeeper contracted with a newspaper to publish an advertisement in which certain articles were listed at the price of $15 each. The newspaper negligently and erroneously printed the price of these articles as $5 each. The newspaper sued the storekeeper for the contract price of the advertisement. The storekeeper set up a counterclaim that he was obliged by law to sell the articles at $5 instead of at $15 and that he thereby incurred a heavy loss. Was his counterclaim a valid defense?

Group II

Answer any five questions in this group. No credit will be given for additional answers, and if more are submitted only the first five will be considered.

No. 6 (10 points):

A promissory note, otherwise negotiable, contained a promise to pay the sum of $50,000 "in successive semi-annual payments of not less than one thousand dollars each, for a period of eight years from date, and the balance then due to be payable on demand thereafter, with interest on the principal unpaid at the rate of six per cent. per annum, payable semi-annually, together with all taxes assessed upon said sum against said payee or the holder of this note." Explain whether or not the foregoing provision affected the negotiability of the note.

No. 7 (10 points):

Defendant was the owner of a half interest in, and was director, vice-president and general manager of, a mutual casualty company, a corporation engaged in insuring owners of taxicabs against damages for personal injuries. As an inducement to plaintiff to purchase defendant's interest in said corporation, defendant gave plaintiff a written statement of the corporation's financial condition which showed a surplus of $112,201.34. In reliance upon said statement, plaintiff purchased defendant's interest, and shortly thereafter an examination by the state insurance department showed a deficit of $47,943.01 as of the date of the statement. The difference lay in the reserve for outstanding losses. The correct amount of that reserve could be determined only by examining some 6,000 pending suits and claims and placing on each a reasonable estimate of liability. No evidence was offered by defendant to show how he had determined the amount of the reserve as shown in his statement. On these facts, should defendant's statement be held fraudulent?

No. 8 (10 points):

A document entitled "Articles of agreement," duly executed, stated that the parties to it agreed to execute a formal lease of certain specified real estate for a specified term of years at a specified rental. The document provided for "the usual and proper covenants" as to possession, surrender and delivery, warranty, re-entry and the like and recited that the lease was to contain "in brief, all of the usual and formal clauses to the mutual satisfaction of the parties." Did the phrase "to the mutual satisfaction of the parties" make the document indefinite, a mere agreement to agree, and thus unenforceable as a contract?

No. 9 (10 points):

X leased a building from Y to be used as a jewelry store. Just prior to the expiration of the lease, Y contracted with Z to wreck the building. Z inspected the building prior to making his contract and in the contract he agreed to a legally enforceable penalty for delay beyond a specified date. Upon the expiration of the lease, X vacated, but he abandoned a large safe which he had placed in the basement of the building. The lease contained no provision applicable to either the installation or the removal of the safe. Z discovered the abandonment of the safe after X had vacated and notified X that he would hold X responsible for the cost of removing and disposing of the safe (which had no sale or scrap value) and also for any penalty for delay necessarily caused by the work of removing the safe. Could Z recover from X on either of these claims?

No. 10 (10 points):

A depositor in the Amalgamated Bank sued the bank to recover the amount paid by the bank upon the forged endorsement of the payee of a cheque drawn by the depositor. At the time the cheque was given to the payee, the latter gave the depositor a promissory note payable on demand for the amount of the cheque. The bank pleaded as a defense that the depositor had been negligent in not making a timely demand upon the payee of the cheque for the payment of the note. Is this a good defense?

No. 11 (10 points):

Plaintiff owned 60% of the capital stock of the Monitor Baking Corporation in the city of X. Defendant, who was president and manager of that corporation, owned 10% of its capital stock. Defendant told plaintiff that he intended to start a baking company of his own in a city over 500 miles away. Plaintiff thereupon contracted to buy defendant's stock in the Monitor Baking Corporation, making a cash payment on account and giving a note for the balance. Immediately thereafter, defendant organized and became president of a new baking corporation in the city of X which was to compete directly with the Monitor company. Before maturity of the note and prior to the transfer of the stock, plaintiff sued in equity for rescission of the contract. Is plaintiff entitled to rescission?

No. 12 (10 points):

In August, 1932, the Blake Building Corporation sold a parcel of real estate at a profit or excess over cost. The purchaser paid part of the selling price in cash and gave a note secured by a purchase-money mortgage for the balance. The cash received was less than 40% of the selling price and the corporation used the instalment basis in its 1932 federal income-tax return. In January, 1933, the corporation was dissolved and all its assets including said note were distributed to its sole stockholder.

(a) If at the time of dissolution the corporation was indebted to its sole stockholder for an amount equal to the amount of said note and the note was accepted by the stockholder in discharge of that debt, how should the corporation account for the balance of the profit on the sale in its 1933 federal income-tax return?

(b) Would your answer necessarily be the same as in (a) if said note were given to the stockholder as part of the liquidating dividend?

Accounting Theory and Practice—Part II

NOVEMBER 17, 1933, 1:30 P. M. TO 6:30 P. M.

Answer problems 1, 2, 3 and 4 and two of the problems 5, 6 and 7.

No. 1 (23 points):

The "A" Corporation (New York), with a branch in Philadelphia, has a wholly owned subsidiary, the "B" Corporation, which was forced into bankruptcy on June 30, 1933. The creditors of "A" Corporation formed a committee, following the application by the Dexter National Bank, Philadelphia, against its loan, of the company's balance of cash on deposit with the bank.

The following trial balances after closing, June 30, 1933, and other data were furnished to the committee by the company:

"A" Corporation (New York books)

Cash — New York Trust Co.	$1,524	Notes payable—Dexter Nat'l. Bank, Philadelphia	$20,000
Securities, at cost (pledged)	14,650	Loans payable—secured, per contra	12,500
Furniture and fixtures	1,000	Capital stock	25,000
Capital stock—"B" Corp.	7,500		
Advances—"B" Corp.	14,640		
Advances—Phila. branch	15,680		
Deficit—per books	2,506		
	$57,500		$57,500

The pledged securities have a market value of $5,200 and the furniture and fixtures an appraised value of $300.

Philadelphia branch (Philadelphia books)

Cash—Dexter Nat'l. Bank, Philadelphia, per bank statement	$1,580	Accounts payable	$19,060
Accounts receivable	10,000	Wages payable	1,550
Merchandise inventory, June 30, 1933	9,500	Taxes payable	800
Furniture and fixtures	7,500	Due to "A" Corp.	15,680
Profit and loss	8,510		
	$37,090		$37,090

The sale of the assets should realize the following: accounts receivable $6,200; merchandise $4,675; furniture and fixtures $2,500.

The cost of liquidation for New York and Philadelphia should be about $4,000.

Receiver and trustee administrative expenses are estimated at $5,000. Cheques for $4,520 to merchandise creditors, on which payment was stopped when bank applied cash on deposit against its loan, have not been adjusted on the above trial balance.

"B" Corporation—Alleged bankrupt
Assets are at estimated realizable value

Accounts receivable	$5,582	Overdraft—Camden bank.	$1,600
Land and building	9,860	Loan payable — Camden bank	7,000
Merchandise inventory, June 30, 1933	7,500	Store wages payable	540
Furniture and fixtures	1,230	Office salaries payable	200
John Doe, president—loan account	300	Executive salary payable—President	1,800
Deficit	34,388	Mortgage payable	12,000
		Mortgage interest accrued.	240
		Real estate taxes payable.	530
		Accounts payable	12,810
		"A" Corporation	14,640
		Capital stock	7,500
	$58,860		$58,860

The salary of John Doe, the president, is $6,000 per annum. The store wages and office salaries are for the two weeks ending June 30, 1933. The "A" Corporation is guarantor on the mortgage and "B" Corporation is on the mortgage bond.

Having engaged your services, the committee has instructed you to prepare, from the above information, statements showing (a) the probable amount which should be available for unsecured claims against "B" Corporation, and (b) the probable amount which should be available for creditors of "A" Corporation in the event of liquidation.

No. 2 (30 points):

You are appointed by the board of directors to examine the accounts relating to the assets and liabilities of The Goodenough Corporation, New York, and its domestic subsidiaries, as at December 31, 1932.

Prepare a consolidated balance-sheet as at December 31, 1932.

The Goodenough Corporation has one foreign subsidiary (wholly owned), the accounts of which have been examined by another firm of accountants whose report, which has been submitted to you, is as follows:

THE BRITISH GOODENOUGH COMPANY, LTD.

Balance-sheet as at December 31, 1932

Liabilities

Share capital:		
Authorized:		
600,000 shares of £1 each	£600,000	
Issued:		
600,000 shares of £1 each		£600,000
Current trade liabilities		78,500

Reserve for income tax payable:		
Due January 1, 1933....................		£90,000
Due January 1, 1934....................		74,500
Indebtedness to affiliated company..........		2,500
Profit-and-loss appropriation account:		
Balance January 1, 1932.................	£12,145	
Net profit for year.....................	298,000	
	£310,145	
Less: Dividends	200,000	110,145
Total		£955,645

NOTE.—There is a liability not included in this balance-sheet in respect to machinery which this company has agreed to purchase.

Assets

Property, plant and equipment at cost, less reserve of £250,000 for depreciation.........................	£450,000
Stock on hand at cost............................	170,000
Customers' accounts receivable, less reserve of £10,000 for bad and doubtful accounts...........	250,383
Cash at bank and in hand (Of this amount the sum of £80,000 is earmarked for a guarantee given on behalf of the company)..........................	85,262
Total	£955,645

Auditor's report

We report to the members that we have examined the above balance-sheet with the books of the company and have obtained all the information and explanation we have required. We are not satisfied as to the adequacy of the reserve for bad and doubtful accounts.

Subject to this remark we are of opinion that the balance-sheet is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs as at December 31, 1932, according to the best of our information and explanations given to us, and as shown by the books of the company.

A. B. C. AND Co.

London, England,
January 31, 1933

You have communicated with the English company and with its auditors and have ascertained the following:

(a) With the exception of machinery costing £100,000, which was installed in November, 1932, when the average rate of exchange was \$3.50, the property, plant and equipment were acquired when the company was formed, when the rate of exchange was at par (\$4.86). The established policy of the company is to charge a full year's depreciation on additions made in the first six months of any year and to charge depreciation commencing January 1st of the year following the year of addition on additions made in the second six months of any year.

(b) Of the stock on hand £160,000 represents goods purchased from The Goodenough Corporation, the parent company, at its cost of \$540,000 plus freight to England of \$36,000 paid by the parent company at the time of shipment. Cost of the remaining £10,000 of British stock approximated market at December 31, 1932. (Note: There had been no change in freight rates to December 31, 1932, and the rate of exchange on that date was \$3.40. You find that The Goodenough Corporation had reduced the cost of its inventory by

10% in order to reflect the lower of cost or market value as at December 31, 1932. The directors have agreed that for the purpose of the consolidated balance-sheet the inventory as a whole should be valued at the lower of cost or market value.)

(c) The auditors of The British Goodenough Company, Ltd., feel that an additional reserve of £50,000 should be provided against the accounts receivable. Neither the directors of the British company nor those of the American corporation can agree that any further reserve is necessary.

(d) The note on the British balance-sheet refers to machinery which it has been agreed shall be purchased from the parent company at its cost less depreciation—net $120,000.

As a result of your examination of the accounts of The Goodenough Corporation and its domestic subsidiaries, you have prepared the following consolidated trial balance as at December 31, 1932, together with your list of audit notes:

Consolidated trial balance as at December 31, 1932

	DR.	CR.
Cash in banks and on hand	$880,000	
U. S. government securities	504,000	
Accounts receivable	1,910,000	
Reserve for doubtful accounts		$210,000
Inventories	1,325,000	
Property, plant and equipment	6,600,000	
Reserve for depreciation		2,500,000
Company's own shares	275,000	
Due from The British Goodenough Company, Ltd.	10,000	

	DR.	CR.
Accounts payable and accrued liabilities.		$2,320,000
Provision for federal income tax........		275,000
Dividend of 50 cents a share payable Jan. 2, 1933		500,000
Capital stock—common, no par, authorized and issued......................		5,000,000
Surplus		3,615,000
Investment in subsidiary company at cost	$2,916,000	
	$14,420,000	$14,420,000

Audit notes

(1) Cash includes a special deposit of $100,000 in the Y Bank & Trust Company. This deposit is subordinate to claims of all other depositors but not to claims of stockholders.

(2) The government securities are stated at cost, although the market value at December 31, 1932, was only $490,000. However, on February 28, 1933, the market value had recovered to $507,000.

(3) The inter-company account is debited or credited at the actual rate of exchange on the date of each transaction, but the balance at the end of each month is adjusted on the books of the parent company by a debit or credit to profit-and-loss account, to bring the account to the basis of a fixed rate of exchange, viz., $4. The actual dollar cost of the £2,500 shown on the British company's balance-sheet was $9,250. There were no items in transit.

(4) In addition to customer's accounts the following items are included in accounts receivable:

(a) Loan to officer $87,000.

(b) Customers' accounts aggregating $370,000, on which payments are deferred by special arrangement until 1934: $50,000 of reserve is allotted to these accounts.

(5) Company's own shares represent 7,000 shares carried at cost and held for resale to employees under employees' stock purchase plan. The market value on December 31, 1932, was $3 per share but the directors will not agree to writing down this asset to market value.

(6) The life of Mr. B., President, is insured for $1,000,000 in favor of the company and the policy at December 31, 1932, had a cash-surrender value of $75,000. All premiums have been charged to expense, as the directors object to setting up cash-surrender value on the books.

(7) There are claims pending against the company which are estimated not to exceed $150,000.

(8) The property, plant and equipment accounts are stated at cost.

(9) Accounts payable include employees' savings deposits, $392,999.

No. 3 (25 points):

On the basis of the following information prepare:

1. An assembly sheet in columnar form to arrive at the figures for the assets and liabilities of the "New Company." No journal entries, formal balance-sheet or work schedules are required.

2. A statement showing the items of which the capital surplus of the "New Company" is composed.

The P Company was an operating and holding company whose position at October 1, 1932, was shown by the following balance-sheet:

Assets

Cash	$150,000
Accounts receivable, less reserve	200,000
Inventories	750,000
Marketable securities—present value	500,000
Investment in subsidiary companies	4,700,000
Fixed assets, less depreciation	8,000,000
Prepaid expenses	50,000
Deficit	1,300,000
	$15,650,000

Liabilities

Accounts payable	$300,000
Bank loan	1,000,000
Trade notes payable	170,000
Unpaid bond interest	280,000
First-mortgage 7% bonds	4,000,000
Eight per cent cum. preferred stock (unpaid dividend $160,000)	2,000,000
Common stock 1,240,000 shares no par	7,900,000
	$15,650,000

The P Company had three subsidiaries. It owned the entire capital stock of the "A", the "B" and the "C" companies and all the bonds of the "A" Company. Their balance-sheets at October 1, 1932, were as follows:

Assets	"A" Company	"B" Company	"C" Company
Cash	$50,000	$20,000	$25,000
Accounts receivable, less reserve	10,000	1,000	2,000
Inventories	250,000	150,000	300,000
Land	2,300,000	1,400,000	1,000,000
Buildings, plant and equipment	700,000	350,000	200,000
Prepaid expenses	20,000	2,000	4,000
Deficit	200,000	70,000	120,000
	$3,530,000	$1,993,000	$1,651,000

Liabilities	"A" Company	"B" Company	"C" Company
Accounts payable	$30,000	$10,000	$15,000
Notes payable	50,000		100,000
Unpaid bond interest		90,000	48,000
First-mortgage 6% gold bonds	1,800,000	1,000,000	800,000
Reserve for depreciation	150,000	93,000	88,000
Capital stock, $100 par	1,500,000	800,000	600,000
	$3,530,000	$1,993,000	$1,651,000

Each of the four mortgages covered land, building, plant and equipment but none of the other assets.

The P Company and its subsidiaries—excepting the A Company—had defaulted on mortgage interest and the P Company had not paid its preferred-stock dividends for the last four quarters. The outside holders of the several securities formed protective committees, and to forestall a receivership a reorganization committee was appointed to outline a rehabilitation plan. Under this plan the outside holders deposited their securities with a trustee. However, the bondholders of the C Company withdrew from the plan and foreclosed their mortgage. They recovered their claim in full, but nothing was left over.

The finally accepted reorganization scheme provided for the formation of a "New" company with 1,000,000 shares no-par-value stock to be set up at $5 per share. Part of this stock was to be issued in exchange for the deposited securities as follows:

Holders of P Company bonds were to get 175 shares and those of B Company bonds 130 shares for each $1,000 bonds including unpaid interest.

Holders of P Company preferred stock were to get 6 shares for each share of $100 par value including unpaid dividend.

To procure additional working capital $5,000,000 new 7% first-mortgage bonds were authorized, of which $2,500,000 were to be issued at 90. A bonus of 10 shares of the new stock was to go with each $200 of new bonds.

The creditor bank agreed to underwrite the above issue subject to the rights of old and new bond and stockholders and provided that the loan of $1,000,000 be paid out of the proceeds. The remainder of the capital stock was to be issued later in accordance with subscription rights given to the common stockholders.

The three sub-companies were dissolved and the New Company took over the assets and assumed the liabilities of the old companies in accordance with the plan and subject to the foreclosure on the C Company property. Fixed assets with relative depreciation were taken over at 50% of book value and the A Company mortgage was cancelled by the P Company. A reserve of $500,000 was set up for contingencies, such as loss on inventories, etc. Reorganization expenses were $100,000.

No. 4 (10 points):

The following is a statement of the profit and loss of the Lacdun Company for the year ended August 31, 1933:

Sales		$600,000
Cost of sales:		
Materials	$195,000	
Direct labor	130,000	
Factory expense	65,000	390,000
Gross profit		$210,000
Selling expenses		$90,000
Administrative and general expenses		40,000
		$130,000
Net profit		$80,000

For the year ending August 31, 1934, it is expected that the sales will increase 33⅓% in volume, while selling and general expense, as well as the production costs, are estimated to advance as follows:

The cost of materials and direct wages are expected to go up 20%, but there will be a reduction of 10% in the material content of the finished product.

Factory expense is expected to be relatively 15% higher.

Selling expense is expected to increase 20% and general expense 25%.

By what percentage must the selling price be increased in order that the net profit for the year ending August 31, 1934, shall exceed that of the previous year by 25%?

No. 5 (6 points):

The premiums on a fire-insurance policy covering a certain building for the amount of $500,000 on a one-year, three-year and five-year basis are as follows:

One year	$1,120
Three years	2,800
Five years	4,480

In each case the entire premium for the full term of the policy is payable in advance.

You are asked to compute the annual cost of this insurance to the insured on each of the three bases, assuming that money is worth 6% per annum.

Given: P 1 at 6%=.9434
P 2 at 6%=.8900
P 3 at 6%=.8396
P 4 at 6%=.7921
P 5 at 6%=.7473

NOTE.—P 1 is the present value of $1.00 at 6% compound discount for one period; P 2 for two periods, etc.

No. 6 (6 points):

Using the data given below, calculate the inventory for a department store, December 31, 1932, by the "retail" method:

	Cost	Original sales price
Inventory, December 31st, 1931	$150,000	$297,000
Purchases 1932	400,000	752,000

Mark-ups during the year not included in above sales price were $15,000.

Mark-downs during the year not included in above sales price were $27,500.

Mark-on percentages are to be considered as uniform among the departments; other factors are equal.

Net sales for the year were $725,000.

Cost of sales for the year was $398,500.

No. 7 (6 points):

The B & D Corporation's balance-sheet of May 31, 1933 shows the following items:

Assets	
Current assets	$10,000
Fixed assets	12,000
Formulæ and goodwill	500,000
Total	$522,000
Liabilities	
Current liabilities	$7,000
Capital stock—common	100,000
Surplus	415,000
	$522,000

You find upon examination that the surplus item of \$415,000 consists of "earned surplus" \$15,000 and "capital surplus" \$400,000.

You are informed that the corporation pays exceptionally large salaries to its officers and that as a result its net earnings average only about two thousand dollars per annum.

In preparing the 1933 "Return of capital-stock tax" of the B & D Corporation for the year ended June 30, 1933, under sections 215 (capital-stock tax of \$1.00 per 1,000) and 216 (excess-profits tax of 5%) of the national industrial recovery act, what factors would you take into consideration in advising the president? Would you suggest a figure at which to declare the value of the capital stock? State reasons for your answer.

Examinations of May, 1934

Auditing

MAY 17, 1934, 9 A. M. TO 12:30 P. M.

Answer the first nine questions and either of the last two.

No. 1 (10 points):

(a) What is a "hidden" or "secret" reserve?

(b) When intentionally created, what four reasons, valid or not, are usually advanced in justification?

(c) Should an auditor ever approve such reserves?

No. 2 (10 points):

The American Institute of Accountants has suggested and the New York Stock Exchange has adopted the following form of report to be used instead of the ordinary "short certificate," viz.:

ACCOUNTANTS' REPORT

"To the XYZ Company:

"We have made an examination of the balance-sheet of the XYZ Company as at December 31, 1933, and of the statement of income and surplus for the year 1933. In connection therewith we examined or tested accounting records of the company and other supporting evidence and obtained information and explanations from officers and employees of the company; we also made a general review of the accounting methods and of the operating and income accounts for the year, but we did not make a detailed audit of the transactions.

"In our opinion, based upon such examination, the accompanying balance-sheet and related statement of income and surplus fairly present, in accordance with accepted principles of accounting consistently maintained by the company during the year under review, its position at December 31, 1933, and the results of its operations for the year."

Compare the above form with the ordinary "short certificate," and state what advantages, in your opinion, it has over the latter.

No. 3 (10 points):

You are employed by a small firm of retail dealers to close its books for the year and prepare a profit-and-loss statement and a balance-sheet. You are not expected to verify the accounts beyond making corrections of obvious errors, such as postings to wrong account and the like.

How should you protect yourself from having the firm use your statements for credit purposes as having been audited by you?

No. 4 (10 points):

The total amount of the inventory of merchandise of a trading concern has been increasing each year for the last three years while the gross profits have been diminishing.

(a) State the probable reasons for this; and

(b) How you would proceed to discover the real cause.

No. 5 (10 points):

If inventory declines in value between the date of statement and that of certification, and the concern audited has a potential loss on purchase commitments, what is the responsibility of the auditor to indicate the loss as of certification date?

No. 6 (10 points):

You are engaged by the directors to make a balance-sheet audit of the X Bank at the close of 1933. You are expressly requested to refrain from seeking confirmation from depositors or borrowers owing to public nervousness caused by the recent failure of another bank in the town, the clients of the X Bank being mainly of the working class unfamiliar with auditing procedure.

At the closing hour on December 30, 1933, you appear at the bank and the head bookkeeper hands you the following:

Balance-sheet, December 30, 1933

Assets		*Liabilities*	
Cash on hand.........	$50,000	Notes payable	$25,000
Due from banks.......	80,000	Due to banks.........	5,000
Stocks and bonds......	100,000	Deposits: demand	530,000
Mortgages owned	200,000	" savings fund.	420,000
Loans and discounts...	600,000	Capital stock	200,000
Accrued int. receiv'l...	10,000	Surplus	100,000
Bank building	50,000	Undivided profits......	21,000
Furn. and fixtures.....	10,000		
Real estate foreclosed..	100,000		
Federal deposit ins.....	1,000		
	$1,301,000		$1,301,000

State how you will proceed to verify the items on the above balance-sheet.

No. 7 (10 points):

In preparing the income-tax return for a state bank you find it has been compelled by the state banking department to write down its stocks and bonds owned to market values as of March 31, 1933, an average reduction of 70%, resulting in showing a heavy book loss. Otherwise the bank's operations for the year would show a small profit. To avoid the federal tax the bank wishes to include the heavy mark-downs as a deduction in its return.

What would you advise, and why?

No. 8 (10 points):

What general procedure should be followed in arriving at a fair valuation of—

(a) Plant account.

(b) Investments.

(c) Patents.

(d) Sinking fund to retire bonds?

No. 9 (10 points):

After a stormy stockholders' meeting and quarrels among the directors, you are engaged by the officers of a corporation to make a balance-sheet audit, the first in the corporation's existence of several years. You find the financial records in order and are ready to certify the balance-sheet, but the officers refuse to produce the minute-book for your inspection, offering instead to furnish you with attested copies of such resolutions as you deem necessary to verify certain items.

What will be your attitude in the matter? State your reasons fully.

No. 10 (10 points):

What is the proper handling of merchandise on consignment in a financial statement prepared for the consignor?

No. 11 (10 points):

You are asked by a client to undertake the recovery of an overpayment of federal income-tax which was due to alleged errors in the return. As an inducement he offers to give you half the amount recovered as your fee. What would be your reply? Give your reasons.

Accounting Theory and Practice—Part I

MAY 17, 1934, 1:30 P. M. TO 6:30 P. M.

Solve problems 1, 2 and 3 and either 4 or 5.

No. 1 (35 points):

From the accounts and information given below prepare:

(a) Consolidated balance-sheet.

(b) Consolidated goodwill and capital surplus account.

(c) Consolidated earned surplus account.

(d) Any necessary comments required for correct interpretation of the accounts as presented.

BALANCE-SHEETS, DECEMBER 31, 1933

	A Company	B Company	D Company
Accounts receivable	$346,480	$132,740	$68,740
Cash surrender value of life-insurance policies	15,480		
Cash in bank	224,682	59,420	9,720
Deferred charges	14,620	6,232	2,740
Inventories	462,000	267,032	109,630
Investment in B Company—4,000 shares at cost	600,000		
Investment in D Company—800 shares at cost		200,000	
Land, buildings, machinery and equipment	897,306	408,784	273,086
Receivable from D Company		16,836	
	$2,560,568	$1,091,044	$463,916
Accounts payable	$326,740	$127,630	$96,940
Reserve for depreciation	370,620	138,760	96,320
Reserve for bad debts	38,000	17,000	10,000
Capital stock—common:			
10,000 shares of $100 each	1,000,000		
5,000 shares of $100 each		500,000	
1,000 shares of $100 each			100,000
Earned surplus	825,208	307,654	143,820
Payable to B Company			16,836
	$2,560,568	$1,091,044	$463,916

EARNED SURPLUS ACCOUNTS

Surplus as at December 31, 1931....	$720,808	$285,672	$126.948
Net operating income:			
Six months ended June 30, 1932..	8,260	2,762	974
Six months ended December 31, 1932	12,390	4,710	2,978
Dividends on B Company stock received September 30, 1933.........	20,000		
Excess of proceeds of sale of E Company stock over cost..............	50,000		
Net operating income:			
Six months ended June 30, 1933..	32,640	11,690	3,276
Six months ended December 31, 1933	81,110	27,820	9,644
	$925,208	$332,654	$143,820
Dividends paid	100,000	25,000	
Earned surplus per books December 31, 1933.................	$825,208	$307,654	$143,820

The A Company acquired 3,750 shares of common stock of the B Company on January 1, 1933, and a further acquisition was made of 250 shares on June 30, 1933, the cost price in both cases being $150 a share. The B Company acquired 800 shares of the D Company—an 80% interest—on June 30, 1932, for $200,000.

The A Company owned all of the capital stock of the E Company from June 30, 1927, to September 30, 1933. At the latter date the stock was sold for $100,000, or $50,000 more than the purchasé price. The net worth of the E Company amounted to $60,460 on June 30, 1927. By December 31, 1932, it had increased through earnings to $87,630 and by September 30, 1933, it showed further earnings, the capital and surplus then amounting to $93,920.

The inventory of the A Company at December 31, 1932, contained merchandise acquired from the E Company, valued at $18,700, the sum billed by the latter company. The goods had been produced by the E Company at a cost of $17,000.

No. 2 (30 points):

As at December 31, 1931, the Pacific Company revalued all of its fixed property on the basis of estimated present replacement cost ("cost to replace new") and the application thereto of accrued depreciation computed according to the expired portion of the estimated life of each item as then determined. The difference between the depreciated value of the fixed assets, as shown by the books, and the depreciated replacement cost, was charged to "earned surplus" and credited to "reserve for revaluation of fixed assets," it being the company's intention to show depreciation in the profit-and-loss account, in future, as follows:

Depreciation based on old book values and revised lives	$........
Less: Credit from "reserve for revaluation of fixed assets"	....
	$........

No depreciation has been or is to be charged in the year of acquisition, but a full year's depreciation is to be charged in the year of expiration or abandonment. The policy of the company has been to depreciate its fixed assets on the basis of estimated life and to revise these estimates from time to time as conditions warrant. From the following statement prepare:

(1) Annual charges for depreciation and property losses for 1932 and 1933.

(2) Statement of "reserve for revaluation of fixed assets account" for the two years ended December 31, 1933.

						Revaluation Dec. 31, 1931	
Item	Date of purchase	Cost	Original estimated life	Estimated salvage value	Dep'n reserve Dec. 31, 1931 per books	Replacement cost	Revised life from Dec. 31, 1931
1	1919	$100,000	25 years	$10,000	$52,000	$70,000	12 years
2	1920	700,000	25 "	40,000	350,000	400,000	9 "
3	"	25,000	20 "	2,000	14,000	20,000	4 "
4	"	75,000	20 "	3,000	37,500	48,000	4 "
5	1923	200,000	15 "	12,000	140,000	140,000	12 "
6	"	50,000	20 "	3,000	22,500	40,000	12 "
7	1924	400,000	25 "	12,000	148,000	300,000	23 "
8	1925	50,000	20 "	2,000	18,000	45,000	14 "
9	1926	100,000	15 "	5,000	40,000	85,000	15 "
10	"	20,000	25 "	2,000	4,800	18,000	15 "

No change was made in salvage values when the fixed assets were revalued.

Item 1 was totally destroyed by fire December 31, 1932.

Item 7 was totally destroyed by fire December 31, 1933.

No. 3 (15 points):

A B C Co., patentee and subsidiary of John Doe & Co., assembled and sold a patented machine for which all the parts were made by and bought from John Doe & Co.

During five years of operations, A B C Co. had sold 2,800 machines at $3,000 each and had made a gross profit of $500 a machine after deducting its overhead of 25% of direct costs. Included in these costs was $1,500 a machine for parts and this included a gross profit of $200 to John Doe & Co., whose overhead ran to 30% of its direct costs.

Both John Doe & Co. and the A B C Co. were equipped to make and sell without additional overhead 25% more machines than had been sold.

A B C Co., together with John Doe & Co., had sued an infringing company for damages representing loss of business and consequent loss of profit. The infringing company had made and sold 460 machines at $2,500 each in the same period and the A B C Co. obtained judgment for the full amount of its claim and costs.

X Y Co., the infringer, organized solely for the assembly and sale of the machine, was a subsidiary of the Z Co. (made co-defendant). The latter company made and sold the infringer all the parts for the infringing machine. The books of the X Y Co. showed the following figures:

	Net profit	Cost of parts	Overhead
1st year	$25,000	$77,000	$23,000
2nd year	50,000	148,500	51,500
3rd year	60,000	187,000	53,000
4th year	55,000	165,000	55,000
5th year	40,000	115,500	44,500
	$230,000	$693,000	$227,000

The sales to the X Y Co. included 10% profit to the Z Co. The X Y Co.'s closing inventory of $25,300 was taken at invoiced cost and consisted of unassembled parts. The Z Co. had no inventory.

The X Y Co. satisfied the judgment in full.

(1) What was the amount for which the A B C Co. on behalf of itself and its parent company sued the X Y Co. and its parent Z Company?

(2) How much did the latter two lose or make, excluding costs of suit, interest and any scrap value?

No. 4 (20 points):

On June 30, 1931, Company A acquires Company B, which uses as its raw material some of the product of Company A.

On September 30, 1931, Company A acquires Company C which uses as its raw material some of the product of Company A and Company B.

Calculate from the following data:

(1) The consolidated profit for the year 1931.

(2) The amount of profit of Companies B and C that is to be treated as a part of the consolidated capital surplus.

	1930	1931
Total sales, including intercompany sales:		
Company A	$3,780,000	$4,380,000
" B	1,300,000	1,100,000
Gross profits:		
Company A	415,800	394,200
" B	228,300	220,000
" C	(not given)	46,000
Purchases from Company A		
Company B	470,000	367,000

Materials included in closing inventories:

	1929	1930	1931
Company A materials:			
In Company B inventory	$113,000	$113,000	$110,000
In Company C inventory	(not given)	24,000	22,000

Company B materials:			
In Company C inventory..	(not given)	$166,000	$120,000

No other information can be procured. It is assumed (1) that all sales to associated companies are made at the same price as the sales to others, (2) that each company sells its goods throughout the year at its average rate of gross profit for the year and (3) that the sales are ratably distributed over the months of the year.

No. 5 (20 points):

On the basis of the following profit-and-loss account of the Excelsior Company and summaries of agreements with Jones and Smith, employees, compute the commissions payable to the latter for the year 1933.

EXCELSIOR COMPANY

Profit-and-loss account for the year ended December 31, 1933

Gross profit before depreciation		$150,000
Depreciation		30,000
Gross profit		$120,000
Selling and administrative expenses (including $2,000 for state taxes)		94,000
		$26,000
Other income, interest, etc.	$25,000	
Less: Interest on mortgage	20,000	5,000
		$31,000
Capital stock tax		1,000
Net profit before special commissions and federal income tax		$30,000

Agreement with Jones:

Special commission to be equal to 15% of the net profit transferred to surplus.

Agreement with Smith:

Special commission to be equal to 15% of the net profit before charging federal and state taxes, interest on mortgage and the commission payable to Smith under this agreement, but after charging, for the purpose of computing this commission only, additional depreciation of $20,000.

Complete the profit-and-loss account and show separately the charges for commission and federal income tax, using 14½% as the rate of income tax.

Commercial Law

MAY 18, 1934, 9 A. M. TO 12:30 P. M.

Reasons must be stated for each answer. Whenever practicable, give the answer first and then state reasons. Answers will be graded according to the applicant's evident knowledge of the legal principles involved in the question, rather than on his conclusions.

Group I

Answer all questions in this group.

No. 1 (10 points):

Williams, a patent lawyer, was rendering legal services to Young on applications for patents which Young had made. Prior to the issue of the patents, Young made a contract with Bostwick whereby Bostwick agreed to conduct and pay for further prosecution of the applications. In this contract no mention was made of Williams or of any other patent lawyer. Williams knew that the contract was made and in reliance upon it he thereafter rendered legal services in the further prosecution of the applications but without the knowledge or consent of Bostwick or Young. Williams sued Bostwick on the theory that Williams was a third party beneficiary under the contract. For whom should judgment be rendered?

No. 2 (10 points):

A savings bank received a letter purporting to be signed by one of its depositors and enclosing that depositor's pass-book. The letter contained a request that a cheque for part of the balance of the account be mailed to him at an address in another state. The bank as requested mailed the cheque and the pass-book, enclosing them with a letter addressed to the depositor. The cheque was presented to the drawee national bank by the writer of the first letter, and he identified himself by showing the depositor's pass-book and the letter written by the savings bank. The national bank paid the cheque. Subsequently the savings bank learned that its depositor's pass-book had been stolen and that the letter purporting to be from him was a forgery. Can the savings bank recover the amount of the cheque from the national bank?

No. 3 (10 points):

Each of the following paragraphs purports to summarize the law on the point involved. State as to each of them whether or not it is correct; if any one is incorrect restate it; and in each instance give the legal reasons on which the rule is based:

(a) A stockholder has a pre-emptive right to participate ratably with other stockholders in subscribing for new shares when the corporation's capital stock is increased and new stock is issued.

(b) A stockholder has the same right with respect to authorized but unissued stock.

(c) A stockholder has the same right with respect to treasury stock acquired by the corporation with the intention of reissuing it.

(d) A stockholder has the same right with respect to treasury stock, acquired by the corporation with the intention of retiring it, which later is offered to investors.

No. 4 (10 points):

Plaintiff entrusted securities to defendant, a stockbroker, for safe-keeping. Plaintiff was not dealing on margin and he was not indebted to defendant in any amount, and defendant charged plaintiff a reasonable fee for his custodianship. Plaintiff gave defendant no authority to hypothecate these securities, but defendant nevertheless pledged them as security for a loan. Defendant became bankrupt and the pledgee of the securities legally and in due form sold them. Plaintiff now sues defendant for the value of the securities and defendant pleads his discharge in bankruptcy as a defense. Discuss the validity of this defense on each of the following assumptions:

(a) Defendant hypothecated the securities wilfully and maliciously;

(b) Defendant hypothecated them through an innocent but mistaken belief that the securities belonged to defendant.

No. 5 (10 points):

Stern, by a written instrument, legally guaranteed the payment by Colt of all charges for goods purchased from the Emporia Company. Colt failed to pay certain proper charges and the Emporia Company sued Colt. During the trial, the case was settled and discontinued upon Colt's written agreement to pay a stated amount in specific instalments, with the proviso that the entire balance of the stated amount would become due upon default in the payment of any instalment. Thereafter Colt defaulted in his second instalment. Is Stern liable on his guarantee?

Group II

Answer any five questions in this group. No credit will be given for additional answers, and if any are submitted only the first five will be considered.

No. 6 (10 points):

Jordan was a salesman on commission with a drawing account. In March, 1932, he was discharged and a dispute arose between him and his employer as to the amount due him. On April 7, 1932, the employer gave Jordan a cheque for $390, marked "Final" on its face and endorsed "Payment in full for commissions earned or to be earned and/or all claims to date." Jordan added to this "Also subject to Mr. Jordan's letter of 4/7/32," endorsed the cheque and cashed it. In his letter of April 7, 1932, Jordan wrote his employer that he was "compelled to receive this cheque under protest subject to adjustment of my account." Did Jordan's acceptance of this cheque constitute an accord and satisfaction?

No. 7 (10 points):

The president of a corporation had power under the by-laws to appoint, to remove and to fix the compensation of employees. Without express authorization from or ratification by the board of directors he made a contract with Jones whereby the corporation was to employ Jones for life. Was this contract binding upon the corporation?

No. 8 (10 points):

The X Dress Corporation made a promissory note payable to the order of "ourselves." Brown was president of that corporation and as such he signed the note. The note was endorsed before maturity by the maker corporation and by Brown individually. Prior to the due date of the note, the X Dress Corporation made an assignment of its assets for the benefit of creditors and said assignment was executed by Brown as president. The note was not paid at maturity and the maker corporation and Brown individually were sued. Notice of dishonor of the note had not been given to Brown. Can Brown be held as endorser?

No. 9 (10 points):

The securities act of 1933 provides that in certain cases of untrue statements or omissions of statements which should have been made, certain persons "may, either at law or in equity, in any court of competent jurisdiction, sue" an accountant who has prepared or certified any part of the registration statement.

(a) Explain what is meant by equity and how it differs from law.

(b) What is the most common remedy obtainable only in equity?

No. 10 (10 points):

Define briefly the following terms (do not discuss or give examples):

(a) last will and testament
(b) legacy
(c) testamentary trustee
(d) principal of trust
(e) life-tenant
(f) remainderman

No. 11 (10 points):

(a) Define and differentiate condition precedent and condition subsequent.

(b) Define and differentiate representation and warranty.

No. 12 (10 points):

Edward Brown was secretary of Charles Brown, Inc., and owned one-quarter of its capital stock, and his father owned three-quarters of it. This corporation was engaged in the grain business in the middle west. In 1922, the corporation was adjudged an involuntary bankrupt, Edward Brown was adjudged a voluntary bankrupt, and each was discharged from existing debts. Thereafter Edward Brown made a contract with another corporation to buy grain for it on a commission basis. In order to reëstablish his standing and credit and revive business relationships with former customers of Charles Brown, Inc., he personally paid most of the business debts of Charles Brown, Inc., which had been discharged in bankruptcy. Can Edward Brown deduct these payments from his commission income on his federal income-tax returns for the years in which he made the payments?

Accounting Theory and Practice—Part II

MAY 18, 1934, 1:30 P. M. TO 6:30 P. M.

Solve problems 1, 2, 3 and 4 and two of the three problems 5, 6, 7.

No. 1 (24 points):

The Mammoth Company has owned a controlling interest in the Glendale Company since the latter company's organization on January 1, 1920, and in its annual published accounts has shown this interest as a single item under "investments." On January 1, 1933, in continuance of its policy to buy up all available outstanding capital stock and debentures of the Glendale Company, the Mammoth Company acquired an additional 53 shares of preferred stock for $2,190. On July 1, 1933, the latter company purchased $23,000 par value of debentures for $20,000 and returned to the Glendale Company for retirement $5,000 par value of debentures. The following statement shows particulars of the Mammoth Company's book record of its interest on December 31, 1933 and 1932.

Investment in and advances to Glendale Company

	December 31, 1933		December 31, 1932	
	Owned	Carried at	Owned	Carried at
Common stock at cost, January 1, 1920, less $980,000 written off to operations..........	19,900 shares	$15,000	19,900 shares	$15,000
Preferred stock at cost..............	14,053 "	602,190	14,000 "	600,000
Debentures at cost..	$78,000 par	76,000	$60,000 par	61,000
		$693,190		$676,000
Current account.....	$5,150,000		$5,275,000	
Less — Written off to operations........	4,125,000	1,025,000	4,125,000	1,150,000
		$1,718,190		$1,826,000

The directors of the Mammoth Company have decided that on December 31, 1933, instead of showing the investment in and advances to Glendale Company as a single item in the Mammoth Company's balance-sheet, the assets and liabilities of the Glendale Company shall be included with those of the Mammoth Company, according to their character, as current assets, fixed assets, debentures or otherwise. As auditor of the Mammoth Company you are in complete accord with this procedure, but you can not accept without verification the following figures which have been included in the consolidation of December 31, 1933, and are presented as being taken from the Glendale Company's balance-sheet of that date.

Current assets	$692,100
Fixed assets	3,098,500
	$3,790,600
Current liabilities	$159,600
Debentures due January 1, 1950	650,000
Earned surplus	1,155,000
	$1,964,600

In support of the above figures the following balance-sheets of the Glendale Company are submitted:

	December 31	
	1933	1932
Current assets	$692,100	$236,500
Fixed assets, less depreciation	3,098,500	3,698,500
Total	$3,790,600	$3,935,000

	December 31	
	1933	1932
Current liabilities	$159,600	$64,000
Debentures outstanding, due January 1, 1950	650,000	700,000
Due to Mammoth Company	7,519,000	7,240,000
Capital stock:		
Common—20,000 shares of $50 each	1,000,000	1,000,000
Preferred—16,000 shares of $50 each	800,000	800,000
Deficit from operations	*6,338,000*	*5,869,000*
Total	$3,790,600	$3,935,000

In the course of your examination you have ascertained:

(1) That up to and including December 31, 1932, the Glendale Company has credited $1,965,000 interest to its account with the Mammoth Company but that the Mammoth Company has not taken up this interest.

(2) That no depreciation has been provided by the Glendale Company for the period from January 1, 1920, to December 31, 1932, although it is agreed that depreciation of $100,000 per annum should have been provided.

(3) That the net loss of the Glendale Company for the year ended December 31, 1933, is $469,000, after charging $600,000 for depreciation, $404,000 for interest on current account with the Mammoth Company and $40,500 for interest on debentures.

(4) That the write-offs on the Mammoth Company's books were intended to reduce the investment to its

share of the book value of the Glendale Company's net assets, less depreciation on fixed assets at the rate of $100,000 per annum.

You are required to submit:

1. A December 31, 1933, balance-sheet of the Glendale Company prepared for ready consolidation with the Mammoth Company's balance-sheet of that date.
2. The investment, current and other accounts on the Mammoth Company's books with the adjustments and changes that will make the record clearer and bring it into agreement with the facts disclosed by the adjusted Glendale Company's books on December 31, 1933.

No. 2 (22 points):

From the following balance-sheets and income accounts of the Universal Machinery Company and its Canadian subsidiary company prepare a consolidated balance-sheet and income account and submit the working papers relative thereto:

UNIVERSAL MACHINERY COMPANY

Balance-sheet, December 31, 1932

Assets

Land	$130,000
Buildings and equipment	400,000

Investment in Universal Machinery Company of Canada, Ltd.		$200,000
Advances to Universal Machinery Company of Canada, Ltd.		30,000
Investment in stock of Universal Machinery Company —500 shares at cost		10,000
Inventories		260,000
Accounts receivable		240,000
Cash		150,000
Deferred charges		25,000
		$1,445,000

Liabilities

Capital stock:		
Common, no par value, 10,000 shares outstanding		$1,000,000
Reserves for depreciation		110,000
Accounts payable		185,000
Surplus:		
Balance January 1, 1932	$140,000	
Net profit for year	70,000	
	$210,000	
Dividend paid—$6 a share	60,000	
		$150,000
Balance December 31, 1932		$1,445,000

UNIVERSAL MACHINERY COMPANY OF CANADA, LTD.
Balance-sheet, December 31, 1932
(Accounts stated in Canadian currency)

Assets

Land		$55,000
Buildings and equipment		130,000
Inventories		80,000
Accounts receivable		60,000
Cash		50,000
Deferred charges		5,000
		$380,000

Liabilities

Capital stock:		
Common, $100 par value, 2,000 shares outstanding		$200,000
Reserves for depreciation		30,000
Accounts payable		50,000
Universal Machinery Company—advances		30,000
Surplus:		
Balance January 1, 1932	$100,000	
Net profit for year	20,000	
	$120,000	
Dividend paid	50,000	
Balance December 31, 1932		$70,000
		$380,000

Income Account for the year 1932

	Universal Machinery Company	Universal Machinery Company of Canada, Ltd.
Net profit from operations..........	$47,000	$25,000
Depreciation @ 5% of buildings and equipment at January 1, 1932......	20,000	5,000
	$27,000	$20,000
Miscellaneous income:		
Dividend received from Universal Machinery Company of Canada, Ltd.	$50,000	
Dividend on Universal Machinery Company stock held as an investment	3,000	
	$53,000	
	$80,000	
Provision for federal income taxes...	10,000	
Net profit for year............	$70,000	$20,000

(1) The Canadian dollar was quoted at 90 cents on December 31, 1932, and at par on January 1, 1932. The average rate for the year was 95 cents.

(2) The investment of the Universal Machinery Company in the real estate, plant and equipment of the Canadian company at January 1, 1932, amounted to $155,000 United States currency.

(3) Additions to the real estate and plant of the Canadian company during 1932 amounted to $30,000 Canadian currency.

(4) The question of income taxes need not be further considered.

No. 3 (15 points):

Compute the federal income tax of Simon Marks, retailer, for the calendar year 1933. His income and expenses for the year were as follows:

Sales		$91,000
Dividends received		870
Profit on sales of real estate, securities, etc.		2,000
Interest received		900
Purchases	$74,000	
Salaries paid	10,400	
Rent	3,000	
Light	1,200	
Donations	280	
Interest paid	1,650	
Advertising	1,350	
Taxes and licenses	520	
Delivery expense	600	

Upon inquiry, you learn the following:

(a) The inventory of goods on hand at January 1, 1933, was $21,000, and at December 31, 1933, was $18,500.

(b) The dividends were received from the following sources:

Domestic corporations which are not exempt from the income tax	$570
Foreign corporations	300
Total	$870

The dividends declared by the domestic corporations on Mr. Marks' stock were $600. However, he received only $570. The remaining $30 was deducted and withheld by the payor corporations as the federal tax on dividends.

(c) The interest received consisted of:

Board of education, city of Chicago bonds....	$212.50
Federal farm loan bonds........................	225.00
Foreign government bonds....................	212.50
Bonds containing a 2% tax-free covenant clause	250.00
Total	$900.00

(d) The salaries paid included a salary of $5,200 paid to Simon Marks.

(e) The donations consisted of the following:

Community chest..............................	$50
Democratic committee..........................	100
The Crusaders.................................	10
Salvation Army...............................	10
Red Cross....................................	25
An indigent relative..........................	25
Christmas bonus to employees.................	60
Total	$280

(f) The taxes and licenses paid were as follows:

Personal property tax.........................	$ 50
Retailers' license.............................	100
Street-improvement tax.......................	100
Real-estate tax on residence..................	210
Automobile licenses...........................	20
Federal cheque tax...........................	20
Tax on club dues..............................	20
Total	$520

(g) The profits from sales of securities, grain, etc., were as follows:

Profit from sale of grain......................		$2,000
Profit from sale of unimproved real estate......		2,000
Total profit..............................		$4,000
Loss from sale of securities which were owned less than two years at time of sale:		
Foreign government bonds........	$1,000	
Stock of domestic corporations....	1,000	2,000
Net profit................................		$2,000

(h) Mr. Marks was married and living with his wife and had two dependent children under 18 years of age throughout the entire year.

No. 4 (15 points):

Charles Black & Co., a corporation, had a factory whose output was absorbed by two customers.

The president and the treasurer each signed cheques, only one signature being necessary. The president bought the raw materials and supplies. The treasurer kept the books, handled the receipts and drew the cheques. Incidentally, he was also receiving teller in one of the local banks patronized by the company.

The accounts of Charles Black & Co. had never been audited until the president demanded an audit which developed at once into an investigation.

All the paid cheques returned by the banks were on hand and available to the auditor, and the cheques received from the two customers were produced on request. After a brief examination of the latter, inquiries revealed that the treasurer had a personal account in his own bank and another in a large bank in an adjacent city.

It was found that $65,000 of customers' cheques had not been credited to them nor entered anywhere on the books (except $10,000 mentioned below). The treasurer had endorsed the cheques for the company in blank in his own handwriting and used them himself by passing them through bank accounts other than those of the company, as evidenced by later endorsements.

There were cheques aggregating $25,000, which had been credited to customers' ledger accounts but not entered in the cashbook nor deposited in the company's bank account. These were similarly endorsed and used.

Cash sales of old machinery and scrap amounting to $1,200 had been made and entered, but the proceeds were retained by the treasurer.

A mortgage was placed on the factory for $10,000 and the company received the money in two instalments of $5,000 each. The full amount was entered in the cashbook as received and credited to mortgage account in the ledger, but only $5,000 was placed in the bank. The other $5,000 was taken by the treasurer, for which he gave his note. An entry crediting cash and charging notes receivable was made by him. Several months later he discounted at the bank a company note for $5,000 to the credit of the company, charging cash as if coming from him and crediting notes receivable. He destroyed his own note. When the company's note was due the bank charged it to the company, but no entry whatsoever was made on the books. The treasurer destroyed this note also. The president of the company knew of the mortgage but denied all knowledge of the notes.

Later another $10,000 was borrowed on the mortgage, but no entry was made on the books. The treasurer turned this money to his own uses. About a month later one customer's cheque for $10,000, as above mentioned, was credited to the mortgage account instead of being credited to the customer.

On the other hand, $30,000 in all was deposited in the bank at various dates to the credit of the company by the treasurer himself, without entry on the books.

Payments to creditors and for salaries and wages and other expenses for the past year, by quarters, aggregated as follows:

	Per cash book	Per cheque book stub	Per cheques
Accounts payable—1st quarter...	$3,225	$2,525	$1,725
" " 2nd " ...	3,000	2,500	2,000
" " 3rd " ...	8,250	7,250	6,250
" " 4th " ...	4,800	4,300	3,500
	$19,275		$13,475
Cash for salaries, wages, etc.:			
" " " 1st quarter....	3,100	3,500	4,100
" " " 2nd " ...	5,600	5,600	6,600
" " " 3rd " ...	1,500	2,000	2,500
" " " 4th " ...	2,700	4,500	5,500
	$32,175	$32,175	$32,175

All correspondence from creditors relative to short payments had been suppressed by the treasurer.

If the candidate finds any evidence of shortage in the figures next above he may consider them part of the defalcation.

Prepare a statement showing briefly the several items making up the total defalcation. Disregard interest. No journal entries are wanted.

No. 5 (12 points):

From the following balance-sheets of the R Company and other information given below prepare a statement of resources and their application in the year 1933:

BALANCE-SHEETS OF THE R COMPANY

Assets

	December 31, 1932	December 31, 1933
Land and buildings	$450,000	$750,000
Machinery	200,000	400,000
Tools	40,000	80,000
Goodwill	200,000	230,000
Investments	95,000	
Inventories	400,000	375,000
Accounts receivable	175,000	250,000
Unexpired insurance	3,000	4,000
Cash	25,000	20,000
	$1,588,000	$2,109,000

Liabilities

Capital stock	\$800,000	\$1,100,000
Bonds	350,000	500,000
Notes payable	70,000	80,000
Accounts payable	145,000	125,000
Accrued interest	7,000	11,000
Accrued taxes	4,000	6,000
Surplus	212,000	287,000
	\$1,588,000	\$2,109,000

During the year a dividend of 4% was declared and paid on the stock outstanding at the beginning of the year. Seven thousand dollars was provided for the depreciation of the buildings; \$16,000 for machinery and \$4,000 for tools. The bonds were sold at par, the stock was sold at 90 and the difference was charged to goodwill account.

No. 6 (12 points):

A machine costing \$256 is estimated to have a life of four years, with a residual value of \$16.

Prepare a statement showing the annual charge for depreciation according to each of the following methods: (a) straight line; (b) constant percentage of diminishing value; (c) annuity method.

Assume the rate of interest to be 10%.

No. 7 (12 points):

The H. Manufacturing Company has been losing money for several years and intends to reorganize.

From the following list of accounts as at December 31, 1933, and other information given below prepare a statement of affairs also showing the amounts that will be realized and the estimated losses on realization:

Advances to employees	$2,657.44
Cash	4,204.67
Creditors	104,231.33
Creditors, preferred	1,716.20
Customers	200,676.93
Capital stock, common	200,000.00
Capital stock, preferred	150,000.00
Capital stock subscriptions	96,400.00
Deficit	133,893.43
Furniture and fixtures	9,197.26
Goodwill	75,000.00
Inventories	75,693.07
Notes payable	189,663.51
Notes receivable	11,462.50
Plant and machinery	33,860.49
Real estate	2,565.25

The original capital stock was $150,000 preferred and $100,000 common, which was fully paid. The subsequent authorized increase of $100,000 common stock is unpaid, except $3,600. The remaining $96,400 is due from wholly insolvent subscribers. The company has assigned $24,072.08 of its customers' accounts, worth their face value, to one of its creditors and estimates that it still has an equity in them of $2,661.81, although this fact does not appear on the books. Of the remaining customers' accounts $46,706 are barred by the statute of limitations and $36,584.03 are more than doubtful. The remaining assets are estimated to be worth as follows:

Inventories	$9,996.42
Plant and machinery	22,088.38
Real estate	1,830.25
Furniture and fixtures	6,697.26
Notes receivable	9,823.40

Examinations of November, 1934

Auditing

NOVEMBER 15, 1934, 9 A. M. TO 12:30 P. M.

The candidate must answer all the following questions:

No. 1 (5 points):

(a) State how a straight voucher system is used, recorded and controlled.

(b) May it be used in conjunction with an accounts-payable ledger, and in what way?

(c) Under what conditions is it preferable in conjunction with an accounts-payable ledger?

No. 2 (10 points):

In the annual audit of the firm of John Doe & Co. you find it has sold a substantial part of its accounts receivable to the X Discount Co., receiving an advance of 60% of their face value, the balance to be received when and as the accounts are collected from customers.

The advance was credited to the account of The X Co. when received, but in closing its books for the year the firm has deducted it from the total accounts-receivable balance on the theory that the accounts sold no longer belong to the firm and that the 40% equity in them is due from the purchaser.

You are requested to certify the resulting balance-sheet in this form without mentioning the sale of the accounts, if possible.

(a) Analyze the above transaction, and

(b) State three methods from which you could choose in order to give a certificate, qualified or unqualified.

(c) Which method would you adopt? Give your reasons.

No. 3 (5 points):

You are employed by the firm of Smith & Jones to close its books and prepare a balance-sheet, profit-and-loss statement, and federal income-tax returns for the firm and for each partner. You are not to audit the books. Neither partner keeps private books but each gives you memoranda of his "other" income and allowable deductions and credits.

With the usual income-tax forms you find additional ones which prescribe:

(1) That the taxpayers must state the fact if they employed anyone, and if so whom, to prepare or advise in the preparation of the return, and to what extent such assistance or advice was received: and

(2) That the person giving such service must make affidavit as follows:

> "I, acting as (advisor or attorney) for the hereto subscribed taxpayer affirm that I prepared the return, that the information set out in the return and accompanying schedules, if any, correctly and truly represents the informa-

tion furnished or discovered by me during the course of preparation of the return, and that such information is true to the best of my knowledge and belief."

(a) How would you word the taxpayers' statements on these forms in the above cases?

(b) As a certified public accountant with all the responsibilities the title implies, what would you do to protect yourself in respect to the affidavit? Give your reasons.

No. 4 (15 points):

In the course of your audit of the X Machine Corporation for the year 1933 you discover that the plant account has been written down one-half its book value by the journal entry—

"Dec. 31, 1933. Reserve for depreciation.. $......
To plant account.............. $......"

You learn that this was authorized by the board of directors, and you are shown a draft of the proposed report to stockholders in which it is recited that the amount represents the net book value, as of January 1, 1933, of plant and equipment which was idle during the entire year; that its purpose is to show the investment in plant at a conservative figure in accord with general conditions due to the depression; that its effect is to confine the annual depreciation charge to plant actually engaged in production during the year; and that the profit-and-loss statement thus shows the true profit made on actual production and sales. It is further intimated in somewhat guarded language that when and as business improves and the idle plant resumes normal production, the value now charged off will be restored to plant account.

State whether or not you will approve this procedure by certifying the corporation's statements, and give your reasons in full.

No. 5 (5 points):

How should the executor of an estate charge the following items as between corpus and income?

1. Physician's fees for last illness.
2. Funeral expenses.
3. Expenses of probating will.
4. General expenses of executor.
5. Loss on sale of investment.
6. Legal fees for collection of rents.
7. Legal fees for defending claims against the estate.
8. Executor's commissions.
9. Repairs to office buildings.
10. Estate and inheritance taxes.
11. Fire-insurance premium.
12. Special assessments adding permanent value to real estate.
13. Monthly allowance to beneficiaries.
14. Expenses incident to a change in executor.

No. 6 (20 points):

Give the program you would follow in making a balance-sheet audit of a small trading corporation.

No. 7 (10 points):

Brown, Smith & Jones, a firm, decide to dissolve partnership and to liquidate the business. Lacking confidence in each other, the partners employ you to conduct the liquidation and to determine the correct amounts due from or to each partner.

Describe in detail the steps you will take.

No. 8 (10 points):

You are making an audit of the X Corporation, among whose assets you find stocks and bonds of the Y Company of a substantial amount. In support of their value you are offered a balance-sheet of the Y Company certified by a fellow member of the American Institute. After careful study of this balance-sheet you are convinced there are serious errors in it and you can not conscientiously accept it. You explain the matter and point out the doubtful items to the officers of the X Corporation, whereupon, after securing the consent of the Y Company, they instruct you to make an audit of the Y Company also.

Bearing in mind the provision in the Institute's rules of professional conduct—that no member shall encroach upon the business of another member—what will you do? Give your reasons. Also state your understanding of the meaning of this provision of the rules.

No. 9 (10 points):

You are engaged in auditing the accounts of the American Manufacturing Company, a small corporation, the president owning approximately 96% of the outstanding capital stock. The company had been exceedingly profitable for a number of years and had invested some of its profits in good marketable securities so that funds would be available for an addition to its plant. Examining the securities you find in place of $25,000 par value of bonds, carried on the books at $20,000, a demand note for $20,000 signed by the president. The minutes of the board of directors show that these securities were lent to the president for his use as collateral to secure some personal transactions which have no relation to the affairs of the corporation. The securities are held by the Manufacturers' National Bank as collateral for the president's personal note, and you have received the bank's confirmation.

How will you show this condition in the balance-sheet and how will you qualify your certificate?

No. 10 (10 points):

You are to audit the accounts of the Kaslek Manufacturing Company at December 31, 1933, and your certified balance-sheet is to be used for credit purposes. On December 28, 1933, the corporation sold a piece of idle property, the terms of sale being one-third cash, one-third in a note due in 30 days and one-third in a note due in 60 days. The price was determined by outside appraisal of October 15, 1933, and your investigation revealed that the transaction was apparently regular in every way. There were the proper resolutions in the minutes and all the necessary documents were produced for inspection. You also find that the cash had been duly deposited. You discover, however, that the purchasing company is controlled by a stockholder of your client, and you suspect that the transaction took place for the purpose of window dressing. On the date of your examination the first note is unpaid and the second note is not yet due. It more than doubled the current assets and therefore greatly improved the current asset position.

How will you deal with these facts in the balance-sheet and certificate?

Accounting Theory and Practice—Part I

NOVEMBER 15, 1934, 1:30 P. M. TO 6:30 P. M.

Solve all problems

No. 1 (25 points):

On January 1, 1933, the F Company purchased 90% of the stock of company G and 80% of the stock of company H. Wishing to acquire the remaining stock of the more profitable company (company H) company F on June 30, 1933, disposed of 200 shares of its holdings in company G at a price of $160 per share, and on that date was successful in acquiring an additional 10% of the stock of company H in exchange for the entire proceeds of the sale of company G stock.

The investment accounts on the books of company F are carried at cost except the account representing the investment in capital stock of company G: this account has been credited with the proceeds of the 200 shares sold.

From the following post-closing trial balances of the three companies at December 31, 1933, prepare:

1. A consolidated balance-sheet
2. A statement of consolidated earned surplus
3. A statement of goodwill

Assets

	F	G	H
Current assets	$152,500	$150,000	$105,000
Investment in subsidiary companies—			
Company G:			
Capital stock	220,000		
Advances	25,000		
Company H:			
Capital stock	214,000		
Advances	40,000		
Buildings and equipment		170,000	235,000
	$651,500	$320,000	$340,000

Liabilities

	F	G	H
Capital stock:			
Company F—3,000 shares	$300,000		
Company G—2,000 shares		$200,000	
Company H—1,000 shares			$100,000
Due to parent company		25,000	40,000
Accounts payable	235,000	40,000	25,000
Surplus at beginning of year	166,500	60,000	145,000
Profit for the year	* 20,000	15,000	40,000
Dividends (paid Dec. 31, 1933)	*70,000*	*20,000*	*10,000*
	$651,500	$320,000	$340,000

* Dividends received from subsidiary companies, less expenses of parent company.

It is assumed that the profits of the companies for the year 1933 were divided equally between the two six months period.

No. 2 (20 points):

John Jones set up an irrevocable trust for the benefit of his eldest daughter, Joan Jones, to run until 1935, when she would be thirty years old and would receive the principal of the estate outright. If she should die before attaining the age of thirty, the trust would go to her younger sister, Ethel Jones. The net income of the trust could be withdrawn by the beneficiary at any time.

By the terms of the trust agreement John Jones was to be trustee during his life and was to receive a fee of $1,000 a year in lieu of commissions.

Any investments made for the trust were to be subject to the approval of the trustee only and not to be bound by any legal rulings regarding trust investments.

There was paid into the trust by gift from John Jones on January 1, 1921, the sum of $100,000 which was to be invested by the trustee.

On December 31, 1930, Joan died and bequeathed her entire estate to her brother Paul Jones to be held in trust for him. He was to receive the income and had the right of appointment of the principal. John Jones was made trustee and was to receive an annual fee of $1,000 instead of commissions.

The trial balance of John Jones, trustee, at December 31, 1930, was as follows:

Debits	
Cash—principal	$7,000
Cash—income	9,550
$300,000 par bonds 4% R. R. & I. due 1955 at cost, investment of principal..........................	275,000
Stocks—2,000 shares of $100 each at cost, investment of undistributed income funds....................	150,000
Oil Venture Syndicate—investment of undistributed income funds	12,500

Accrued interest on bonds	$950
Payments to beneficiary from income during 1930	2,500
Expenses applicable to income for year 1930	1,850
Expenses applicable to principal paid during 1930	1,000
Trustees' fees for year 1930	1,250
	$461,600

Credits

Principal of trust—balance January 1, 1930	$275,000
Undistributed income balance January 1, 1930	138,500
Interest on bonds	12,800
Dividends	14,000
Profits on sale of principal investment bonds	9,200
Profits on stocks sold	9,600
Due trustee for fees	2,500
	$461,600

Analysis of undistributed income at January 1, 1930:	
Interest received	$80,000
Dividends received	89,000
Profits on stocks sold	30,000
	$199,000
Expenses charged to income	$16,500
Fees to trustee	9,000
Payments to beneficiary	35,000
	$60,500
Balance December 31, 1930	$138,500

Analysis of principal at January 1, 1930:

January 1, 1921	$100,000
Increase to principal through sale of investments.	190,000
Total	$290,000
Payment of expenses applicable to principal	15,000
Balance December 31, 1930	$275,000

During the three years ended December 31, 1933, the following transactions took place:

On December 31, 1931, the Oil Venture Syndicate was liquidated by receiving (a) 1,000 shares no-par-value stock of the Oklahoma Oil Producers, Incorporated, of which the market value at December 31, 1931, was $10 a share; (b) $6,250 in cash; and (c) $12,500 5% Stanton Oils of California bonds due in 1955 of which the market value at December 31, 1931, was 80.

During the year 1932 the trustee sold $150,000 par value of the 4% R. R. & I. bonds at a net profit of $25,000 and invested the money in U. S. government 3¾% bonds at 100 net.

During 1932 the trustee invested $10,000 of undistributed income funds of the Paul Jones trust in Standard Oil of New Jersey at $40 per share, receiving 250 shares; the expense of the purchase amounted to $50.

On January 25, 1933, the trustee sold $12,500 par value bonds of Stanton Oils of California for $12,500 net and invested the proceeds in Tulsa city 4% bonds at 100 net.

During the three years ended December 31, 1933, there was collected:

Interest on R. R. & I. bonds	$26,321.25
Interest on Stanton Oils of California	625.00
Interest on U. S. government bonds	10,053.75
Interest on Tulsa city bonds	500.00
Dividends on stocks	40,000.00

During the same three years there was disbursed:

Payments to Ethel Jones as beneficiary	$6,000.00
Payments to Paul Jones as beneficiary	10,000.00
Expenses paid chargeable to income of the principal trust	4,000.00
Expenses paid chargeable to income of the undistributed income trust	3,500.00
Fees paid trustee	3,000.00
The account payable to trustee at Jan. 1, 1931, was liquidated	

No legal accounting was filed by the trustee during the whole period of the trusts.

Prepare statements from which the trustee may file this legal accounting. Disregard all taxes.

No. 3 (20 points):

The "A" Telephone Company was incorporated on January 1, 1931, for the purpose of acquiring and holding securities of companies operating telephone systems. The authorized capital stock consisted of 2,500 shares of $6 cumulative preferred stock without par value and 3,000 shares of common stock without par value. The authorized funded debt was $500,000. On January 1, 1934, three years later, the company voluntarily filed a petition in bankruptcy. An attorney for the bondholders' committee has asked you to examine the accounts and records of the company to determine why it was necessary to file such a petition when it had a surplus of $361,500 as shown by the following analysis of the company's surplus account:

Analysis of surplus account
January 1, 1931, to December 31, 1933

Date		Debit	Credit
1- 1-31	Excess of consideration paid in by shareholders, for shares having no par value, over the amount allotted to stated capital, as follows:		$285,000
	Cash paid in by shareholders........ $500,000		
	Capital stock issue:		
	2,000 shares $6 dividend, no par, preferred stock, stated value $100 per share................ $200,000		
	3,000 shares no par common stock, stated value $5 per share.... $15,000 $215,000		
	Excess consideration paid in........ $285,000		
1- 1-31	Discount on purchase of 5,000 shares (total authorized) "B" Telephone Company common stock, par value $100 per share. The company entered this stock in its investment account at par, $500,000...........		$10,000
7- 1-31	Discount on sale of $500,000 par value "A" Telephone Company 6% ten year debenture bonds, dated 7-1-31.....................	$50,000	
12-31-31	Net profit from operations for the year ended December 31, 1931, (includes $50,000 undistributed profit for the same year, of the "B" company which was taken into earnings by charging that company's current account)...		20,000
12-31-31	Dividends declared on preferred stock for the year ended December 31, 1931.............	12,000	
12-31-31	Dividends waived by shareholders owning 500 shares of preferred stock..................		3,000
1- 1-32	Discount on purchase of $400,000 par value "C" Telephone Company 5%, twenty year, sinking fund gold bonds, dated January 1, 1922....................................		20,000
6-30-32	Unrealized profit from the exchange of "B" Telephone Company's common stock for 6,000 shares (total authorized) "C" Telephone Company common stock without par value. The latter stock was taken into the investment account at the stated value thereof, namely, $600,000..................		100,000
6-30-32	Discount on sale of 500 shares of "A" Telephone Company $6 cumulative preferred stock, stated value $100 per share..........	5,000	

Date		Debit	Credit
12-31-32	Net profit from operations for the year ended December 31, 1932, (includes $20,000 undistributed profit for the six months ended December 31, 1932, of the "C" Telephone Company which was taken into earnings by charging that company's current account)...		$10,000
12-31-32	Dividends declared on preferred stock for the year ended December 31, 1932..............	$13,500	
1- 1-33	Discount on purchase of 600 shares of the company's preferred stock. This stock was canceled..................................		9,000
12-31-33	Net loss from operations for the year ended December 31, 1933........................	15,000	
		$95,500	$457,000
			95,500
	Balance December 31, 1933..................		$361,500

The articles of incorporation authorize the directors to purchase preferred capital stock which is to be retired from earned surplus.

At the date of filing the petition in bankruptcy, the total investments owned by the company consisted of the 6,000 shares of "C" Telephone Company's common stock and $5,000 par value, United States Treasury bonds. The latter bonds were purchased at par. The "C" Telephone Company went into the hands of a receiver on July 31, 1933.

From the foregoing data prepare an adjusted analysis of surplus account. Comment briefly upon any additional facts which you feel will be of value to your client.

No. 4 (15 points):

On April 1, 1929, a company sold $500,000 of its first-mortgage bonds at 90. The bonds matured to the amount of $50,000 on each of the next ten anniversaries of the date of issue. Those due in 1930 were paid; those due in 1931 were not paid but by agreement with the holders were extended for one year.

During 1930 the company borrowed from its officers 1,250 shares of its own capital stock of a par value of $100 each (out of 1,300 shares outstanding) and obtained a bank loan of $100,000 with these borrowed shares as collateral. Interest was paid on this loan and on the bonds, but the bond maturities in 1932 were not met. The officers resigned and were replaced by executives approved by the creditors. The collateral to the bank loan was offered for sale at public auction and bought in by the bank for $20,000, which was applied in reduction of the loan. Thereafter the new officers of the company, in their personal and private capacities, entered into an agreement with the bank, which contained the following provisions:

(1) The bank agreed to sell and the officers to buy the 1,250 shares of stock for $20,000 payable at the rate of $500 per month plus interest, beginning January 1, 1933.

(2) The officers agreed to seek a five-year extension of the maturities on all bonds which by their face were due on or after April 1, 1933; these efforts were made and proved successful before that date arrived.

(3) The bank agreed to (and did) acquire all of the bonds which had matured on April 1, 1932, and agreed further that it would not exercise any of its rights to enforce collection of either these past-due bonds or of the now unsecured loan so long as (a) the officers were not in default on their stock-purchase obligations

and (b) interest on the past-due bonds and the unsecured loan was paid currently; provided, however, that the company made quarterly payments, to apply on the principal of the past-due bonds and unsecured notes, equal to as many multiples of $5,000 as might be paid from the sum of its net income and the net accretion to its depreciation reserve, computation of these amounts to begin as at April 1, 1933, and to be cumulative, and payment to be made within thirty days after the close of each quarter.

During its fiscal year ended March 31, 1934, the company's net income before depreciation was respectively $8,000, $16,000, $14,000, and $12,500 for the first, second, third and fourth quarters; expenditures for replacements charged against its depreciation reserve were respectively $4,500 and $6,000 for the first and second quarters. All interest obligations were met and payments to apply on the principal of past-due bonds and on the unsecured loan were made in accordance with the agreement outlined above. At March 31, 1934, the company's only indebtedness other than that discussed herein consisted of audited vouchers for current purchases and expenses amounting to $35,000, including interest due April 1, 1934, and its surplus was $67,500.

1. Prepare a statement showing the liabilities side of the company's balance-sheet at March 31, 1934, in such form as in your opinion would merit an unqualified certificate.

2. Explain any changes which you would make in that statement if the company had been a party to the agreement outlined above.

3. Explain how the amortization of the cost of floating the bond issue in 1929 would be affected by the extension secured in 1933.

No. 5 (10 points):

Adams and Bede commence in business in copartnership on January 1, 1930. Adams contributes $40,000 as capital and Bede $25,000. It is agreed that profits will be divided in the proportions of ⅔ to Adams and ⅓ to Bede and that 6% interest per annum will be credited on the original capitals. No interest is to be charged on drawings or credited on any excess of interest and profits over drawings. During the term of the partnership Adams' drawings amount each year to $10,000 and Bede's to $7,500. At the close of business on December 31, 1932, Bede retires from the firm and is paid from partnership funds the balance standing to the credit of his capital account. The net profits of the partnership were proportionate to the sales which for the three years ended December 31, 1932, respectively amounted to $250,000, $200,000 and $175,000. Adams will continue the business as a sole trader and at the commencement of business on January 1, 1933, prepares the following statement from the books:

Cash	$10,203.16
Accounts receivable	16,813.87
Inventories	24,311.97

Prepaid expenses	$250.00
Fixed assets	40,000.00
Goodwill	15,000.00
	$106,579.00
Accounts payable	$24,861.05
Notes payable	15,000.00
Accrued liabilities	750.00
Reserves:	
For bad debts	2,500.00
Depreciation	12,000.00
	$55,111.05
Capital	51,467.95
	$106,579.00

Prepare a statement of the partners' capital accounts for the three years ended December 31, 1932.

No. 6 (5 points):

A and B were partners under an agreement that the profits were to be equally divided and that A was to furnish one-fourth and B three-fourths of the capital actually used during each calendar year, interest at 6% per annum to be charged or credited on any differences.

Examine the following transcripts of their capital accounts and ascertain whether or not the entries at the end of the year were correctly made.

A—Capital

Debits			Credits		
Sept. 1, 1933	Withdrawal...	$3,000	Jan. 1, 1933	.....	.... $10,000
Dec. 31	Interest on above for 4 months ...	60	Dec. 31	P. & L	4,400

B—Capital

Debits			Credits		
July 1, 1933	Withdrawal..	$2,000	Jan. 1, 1933	....	$30,000
Dec. 31	Interest on above for 6 months ...	60	Dec. 31	P. & L.	4,400

No. 7 (5 points):

The Theatre Company rented films from the Film Company and agreed to pay as rental 15% of the Theatre Company's gross receipts up to a point where it earned a profit (before deducting the rental) equal to one-half of the total rental and beyond that point at the rate of 50% of the gross receipts.

Calculate the film rental for a period in which the gross receipts amounted to $1,000 and the expenses (other than rental) amounted to $400.

Commercial Law

NOVEMBER 16, 1934, 9 A. M. TO 12:30 P. M.

Reasons must be stated for each answer. Whenever practicable, give the answer first and then state reasons. Answers will be graded according to the applicant's evident knowledge of the legal principles involved in the question rather than on his conclusions.

Group I

Answer all questions in this group.

No. 1 (10 points):

Backus, in the excitement of a railroad accident, lost unregistered coupon bonds and stock certificates endorsed in blank which he had been carrying in a brief case. These were found by another passenger who made no attempt to ascertain or find the loser but two weeks later sold the bonds and the certificates. The purchaser paid full value for them and had no knowledge of Backus' loss. Did the purchaser become the legal owner of the bonds and the certificates?

No. 2 (10 points):

Andrews was appointed trustee of certain real property by a written instrument which specified that the income was to be paid to a named beneficiary during the latter's life and that title to the property was to be conveyed to another beneficiary upon the death of the life-tenant. What duties, if any, may Andrews delegate to assistants or agents?

No. 3 (10 points):

(a) Define "ultra vires" as used in the law with respect to corporations.

(b) Give an example of an ultra-vires act.

No. 4 (10 points):

Watson and Titus were partners, under a partnership agreement which made no mention of the death of either. Watson by his will bequeathed his interest in the partnership to his wife. Upon Watson's death, did his wife become a partner with Titus by virtue of this legacy in Watson's will?

No. 5 (10 points):

Davis borrowed money from Harrison and gave him as security a power of attorney to collect future rents from Davis' tenants.

(a) Would this power of attorney be canceled by Davis' death prior to the repayment of the loan?

(b) Can a tenant who knows of Davis' death discharge his obligation for rent accrued prior thereto by paying Harrison?

Group II

Answer any five questions in this group. No credit will be given for additional answers, and if additional answers are submitted only the first five will be considered.

No. 6 (10 points):

Kenyon was a business man in the city of X. He signed a subscription list by which he agreed to contribute $1,000 towards the purchase of a building for the local chamber of commerce. Other subscribers for the same amount signed this list both before and after Kenyon signed it and Kenyon knew of these other subscriptions. The building was purchased in accordance with and in reliance upon this subscription list. Can Kenyon be compelled to pay the amount of his subscription?

No. 7 (10 points):

Define and explain briefly (a) patents, (b) copyrights and (c) trademarks.

No. 8 (10 points):

A drawee of a draft, in answer to an inquiry by the payee, wrote that he would honor a draft for $1,000 by Samuel Thompson. A draft on this drawee by Samuel Thompson for $1,000 was duly presented but acceptance was refused because the words "with exchange" had been added. Can the payee collect from the drawee?

No. 9 (10 points):

Define "common law" and briefly differentiate it from statutory law.

No. 10 (10 points):

In a state where gambling is and always was unlawful, Olsen owes Marks a gambling debt and Marks engages Shepard to collect it on a 25% fee. Shepard collects the amount of the debt but refuses to transmit any part of it to Marks. Can Marks recover in an action against Shepard?

No. 11 (10 points):

Define "stoppage in transit," state who may exercise this right, and in general when the right ceases to exist.

No. 12 (10 points):

Emerson rented a furnished apartment containing a radio connected with receiving wires on the roof of the apartment house (with which radios in other apartments also were connected). Emerson removed this radio and substituted one of his own without injury to the connecting wires. At the termination of his lease he removed his own radio and reconnected the landlord's. The landlord claimed both radios. On what principle of law was this claim based? Should the landlord's contention be sustained?

Accounting Theory and Practice—Part II

NOVEMBER 16, 1934, 1:30 P. M. TO 6:30 P. M.

Solve all problems.

No. 1 (30 points):

On December 31, 1928, the Star Drug Company with an outstanding capital of $500,000, the Mormon Drug Company with an outstanding capital of $400,000 and the Gulf Drug Company with an outstanding capital of $450,000—all shares of $100 each—merged into one operating company known as Continental, Inc., with a capital stock issue of 1,350,000 shares of no par value.

The stockholders of the three merging companies received the 1,350,000 shares in return for their aggregate holdings of $1,350,000 par, i. e., 100 shares of Continental, Inc., for each share of the merging companies. On the above date Continental, Inc., also took over all the assets and liabilities of the three companies. Their individual charters were, however, kept alive.

On December 31, 1933, five years later, the balance-sheet of Continental, Inc., was:

Assets

Cash		$150,000
Accounts receivable:		
Star Drug Co. customers............	$125,000	
Mormon Drug Co. customers........	100,000	
Gulf Drug Co. customers...........	70,000	295,000

Inventory:		
Star Drug Co. products, materials, etc.	$140,000	
Mormon Drug Co. products, materials, etc.	120,000	
Gulf Drug Co. products, materials, etc.	115,000	$375,000
Plant and equipment at present values appraised on December 31, 1933:		
Star Drug Co. plant	1,500,000	
Mormon Drug Co. plant	1,300,000	
Gulf Drug Co. plant	1,000,000	3,800,000
		$4,620,000

Liabilities

Accounts payable		$89,000
Bonds of subsidiary companies:		
Star Drug Company	$1,197,400	
Mormon Drug Company	783,160	
Gulf Drug Company	519,440	2,500,000
Capital stock outstanding		785,000
Surplus		1,246,000
		$4,620,000

At December 31, 1933, Continental, Inc.'s stockholders decided to decentralize and restore to each of the original companies its proportion of assets and liabilities. The net worth was to be prorated on the basis of each company's capital investment on December 31, 1928, and it was found that the Star Drug Company was to receive 40%, the Mormon Drug Company 36% and the Gulf Drug Company 24%.

On December 31, 1928, the three merging companies owned each other's stock as follows:

The Star Drug Company owned—	
1,200 shares Mormon Drug Co., cost	$100,000
2,500 shares Gulf Drug Co., cost	200,000
The Mormon Drug Company owned—	
1,000 shares Gulf Drug Co., cost	75,000
500 shares Star Drug Co., cost	50,000
The Gulf Drug Company owned—	
50 shares Mormon Drug Co., cost	10,000
400 shares Star Drug Co., cost	30,000

A summary of Continental, Inc.'s surplus shows:

Surplus of merging companies—December 31, 1928	
Star Drug Company	$190,000
Mormon Drug Company	375,000
Gulf Drug Company	81,000
Excess of par over book value of intercompany holdings	100,000
Earnings of five years	892,500
	$1,638,500
Less—Dividends paid	392,500
Balance, December 31, 1933	$1,246,000

It was decided that in the redistribution each of the three companies would receive a proportionate share of the cash; its own accounts receivable and inventory; its original investments in the other companies at original cost to itself and its own plant and equipment. On the other hand, each would assume a proportionate share of the current liabilities but would become wholly liable for its own outstanding bonds. All differences were to be charged or credited to current account for future settlement.

From the foregoing data prepare:

1. A statement showing in columnar form the balance-sheets of the three drug companies after decentralization on December 31, 1933.
2. A statement showing that the adopted ratio 40:36:24 approximately agrees with the proportions existing on December 31, 1928.

No. 2 (20 points):

The following accounts covering the year 1933 are submitted by The Electric Company which sells and installs electric alarm systems for banks and other institutions:

Balance-sheet—December 31, 1933

Assets

Current assets:		
Cash	$25,000	
Accounts receivable	237,500	
Inventories	53,000	
Unbilled contracts	38,000	$353,500
Fixed assets:		
Factory equipment	$164,000	
Less: reserve for depreciation	33,000	131,000
Patents, less amortization		75,000
Prepaid insurance, commissions, etc.		13,500
		$573,000

Liabilities

Current liabilities:		
Accounts payable	$80,800	
Salesmen's commissions	9,500	
Accrued wages	2,700	$93,000
Capital stock:		
Six per cent. preferred	$200,000	
Common	50,000	250,000
Earned surplus:		
Balance, January 1st	$102,000	
Net profit for 1933	140,000	
	$242,000	
Less: preferred dividends paid	12,000	230,000
		$573,000

Profit-and-loss statement

Year ended December 31, 1933

Income from contracts:		
Installation contracts	$313,000	
Repair service	30,000	
Inspection contracts	50,000	$393,000
Cost of contracts:		
Materials, labor and factory overhead:		
Installation contracts	$131,250	
Repair service	20,000	
Inspection contracts	10,000	161,250
Gross profit on contracts		$231,750

Selling expenses	$60,000	
General and administrative expenses	38,750	$98,750
		$133,000
Other income		7,000
Net profit for year		$140,000

Additional information is procured as follows:

1. Accounts receivable segregation:

Completed contracts—current	$110,000
Completed contracts—due July 1, 1935	25,000
Due from officers and employees—current	7,000
Uncompleted installation contracts—billed	75,000
Overdrawn salesmen's accounts	2,000
Stockholders' subscription, represented by demand note receivable, dated March 1, 1928	7,500
Contract balance, past due, secured by customer bank stock, face value $12,000 not marketable	11,000
	$237,500

2. Preferred dividend for half year ended December 31, 1933, declared December 15, 1933, payable January 15, 1934.
3. Installation contracts are not collectible until completed.
4. The cost of installation contracts equals 50% of the installation contract income.
5. Uncompleted installation contracts (billed in 1932), one-half completed at December 31, 1932...... $75,000
6. Uncompleted installation contracts, one-third completed at December 31, 1933, and fully billed to customers...... 75,000

7. Unbilled contracts, no work thereon at December 31, 1933 .... $38,000
8. Inspection service contracts are billed annually in advance, the charges being of uniform amount each month. The billings in 1932 were the same as in 1933.
9. Federal and state taxes are estimated to equal $17\frac{1}{2}\%$ of the net profits. The change in the method of accruing income need not be considered.

Prepare the adjusted balance-sheet and profit-and-loss account, also a surplus account showing the adjustments thereto.

No. 3 (10 points):

A corporation presents the following condensed statement as of the close of the year:

Cash	$90,000	Dividends payable.	$.......
Other assets	1,510,000	Other liabilities....	500,000
		Common stock.....	500,000
		6% preferred stock	300,000
		8% preferred stock	200,000
		Surplus	100,000
	$1,600,000		$1,600,000

The 6% stock is cumulative, the 8% stock is non-cumulative, and both participate equally in the remaining surplus profits by being entitled to an extra dividend equal to the excess of any common dividend rate over and above 6% per annum.

A. Compute the book value per share for each class of stock in the following cases:

1. Current year's dividends unpaid.
2. Dividends unpaid for two years.
3. Dividends unpaid for three years.

B. What dividends could legally be declared to the various classes of stockholders, assuming that the 6% stock is non-participating, the 8% stock is participating on the basis stated and no dividends are in arrears?

No. 4 (10 points):

At a given date the condensed balance-sheets of two firebrick companies were as follows:

Alpha Firebrick Co.

Fixed assets, at cost less depreciation	$1,800,000	Capital stock: Authorized—12,000 shs. Issued—8,000 shs.	$800,000
Current assets	867,000	Liabilities	620,000
Goodwill	None	Surplus	1,247,000
	$2,667,000		$2,667,000

Beta Firebrick Co.

Land at cost	$277,000	Capital stock	$500,000
Buildings at cost, less depreciation	50,000	Liabilities	120,000
Equipment, at cost less depreciation	100,000	Surplus	257,000
Current assets	100,000		
Goodwill	350,000		
	$877,000		$877,000

Alpha Company then bought all the assets of Beta Company, giving in payment $400,000 of its own stock. This purchase price included payment at book value for buildings, equipment and current assets, the balance being payment for the land. The latter contained a deposit of fireclay estimated at 12,000,000 tons, which was the primary reason inducing Alpha Company to acquire the properties. It was estimated that when the clay deposit was exhausted the residual land would be worth not more than $10,000 and the equipment and buildings would be worth nothing. The goodwill on the books of Beta Company had been set up in the early post-war years by a credit to surplus, in an attempt to set up a large investment for purposes of excess-profits tax.

How should the properties be taken up by Alpha Corporation and what charges to profit and loss should be made thereafter in respect to depletion, depreciation and obsolescence, assuming (1) that the buildings would outlast the clay deposit and that the equipment would be sufficiently provided for by an annual provision of 10% of the cost to Alpha Company. Use straight-line rates, on per ton or time basis, as you think proper. Give reasons for what you do.

No. 5 (5 points):

K Company holds a first mortgage of $25,000 and L Company a second mortgage of $10,000 on real estate of M Company.

M Company has defaulted in payment of one year's interest of $1,500 on the K Company mortgage and assigns future rents to K Company authorizing the latter to manage the property as mortgagee in possession.

Six months later L Company institutes foreclosure proceedings and pending final sale thereunder the K Company is appointed by the court as receiver for rents.

How should the rents and expenses be treated in the books of K Company during (a) the first six months (b) the second six months? Give reasons.

No. 6 (5 points):

Your audit of the records of N, a bankrupt company, disclosed the following entries made one day before adjudication by the court.

(a) Journal entry crediting the account receivable of O Company and debiting the account payable of O Company with $10,000 to offset accounts representing mutual dealings.

(b) Cashbook entry applying entire bank balance of $25,000 in reduction of an unmatured note of $50,000 to the same bank.

(c) The sale and delivery of all merchandise on hand at current market sales prices to P Company, holder of unmatured notes payable of the N Company which are personally endorsed by officers of the N Company. The merchandise is delivered in full and final settlement of these notes.

Comment upon these transactions.

No. 7 (5 points):

In 1929 T Company purchased a large factory building and, to finance the deal, executed a purchase-money mortgage of $100,000 payable in 10 years. In 1933 it sold the property to U Company which deducted from the sales price of $150,000 the amount due on the purchase-money mortgage of $100,000.

In the course of your examination of the books of T Company for the year ended December 31, 1934, you find a journal entry recording the sale of the property.

How should the realty transaction be shown on the balance-sheet, assuming that there is a marked deflation in realty values and that the U Company was declared bankrupt on December 1, 1934?

No. 8 (5 points):

The Island Syndicate offers to build a bridge across The Narrows at a cost of $20,000,000 and to accept in payment the city's 4% bonds, redeemable in 25 years, interest payable semi-annually. The annual maintenance charges are estimated at $50,000 a year. It is proposed to charge tolls—5 cents for foot passengers and 50 cents for vehicles. Based on these charges and assuming a ratio of foot passengers to vehicles of 1 to 20, how many tolls of each class would be necessary each year in order to provide for maintenance, interest and a sinking fund (earning the same rate of interest as the bonds) sufficient to retire the bonds at maturity? The amount of $1 after 50 interest periods is $2.692.

No. 9 (5 points):

On January 1, 1930, the V Company issued $1,000,000 bonds at 95. In terms of the issue $200,000 are to be retired on January 1, 1933, and $500,000 by annual amounts of $100,000 on January 1st of each of the five years next succeeding, the balance of $300,000 to be retired on January 1, 1939. Prepare a table showing the amortization of the discount by the bonds-outstanding method.

No. 10 (5 points):

In the course of your examination of the accounts of the Grander Company, Incorporated, you find that the company entered into certain irregular transactions. The company may be liable for damages as a consequence of the first of these transactions, while in the second it has performed a contract which is voidable by the other party who appears on the company's books as a debtor for the agreed contract price. In the third place certain ultra-vires transactions have been fully completed on both sides but others are still open, the company including in its book debts the amount due from the second party arising out of these transactions.

How would you deal with the foregoing transactions in your report?

Examinations of May, 1935

Auditing

MAY 16, 1935, 9 A. M. TO 12:30 P. M.

The candidate must answer all the following questions.

No. 1 (5 points):

(a) What is meant by "fixed" and "variable" overhead costs in cost accounting for a manufacturer?

(b) Give examples of each.

(c) How will increases and decreases in production affect the variable and fixed overhead in the cost per unit?

(d) Illustrate by example your answer to (c).

(e) Why should any distinction between fixed and variable costs be recognized?

No. 2 (15 points):

A summarized balance-sheet, presented to you for examination, is stated in the following terms:

Balance-sheet as at December 31, 1933

Assets		*Liabilities*		
Current assets	$1,600,000	Current liabilities..		$800,000
Prepaid expenses ..	50,000	Contingency reserve		100,000
Plant account less reserve for depreciation	2,050,000	Preferred stock 7% Cum.		700,000
		Common stock		1,500,000
		Earned surplus: balance at Dec. 31, 1932 ...	$450,000	
		Net income 1933 ...	150,000	600,000
	$3,700,000			$3,700,000

According to the terms of the preferred-stock issue a sum of $50,000 is set aside annually "out of surplus" for the retirement of preferred stock, the instalment for each year to be deposited on March 1st of the succeeding year. At December 31, 1933, preferred stock of a par value of $300,000 had been retired through the sinking fund by purchases at par during the six years in which the fund had been in operation.

The contingency reserve was charged during the year with certain exceptionally large credit losses amounting to $100,000. When the contingency reserve of $200,000 was created by the board of directors out of surplus in 1931, it was felt that certain customers were receiving unduly long terms of credit, but it was the belief that they would eventually pay their bills. By 1933 balances to the amount of $100,000 were found to be irrecoverable, and they were written off against the contingency reserve, as stated.

Assuming that the current assets, the liabilities and the plant account have been satisfactorily verified, and that you have reviewed the operations of the company for 1933

(a) Submit your criticisms of the balance-sheet and discuss any points on which you may desire to take issue; and

(b) If you consider changes necessary, redraft the balance-sheet and present a summary of the surplus account, showing the sources of increase in 1933 and the proper distribution of the balance at December 31, 1933.

No. 3 (10 points):

While auditing an investment bank you learn that the president and treasurer hold similar positions in a savings bank in the same city and have unrestricted access to the securities of both banks.

(a) What would this situation suggest to you?

(b) How would you deal with it?

No. 4 (6 points):

You are making a balance-sheet audit of a concern whose business is importing and exporting. You find it has been the custom to charge to an account entitled "Freight and charges prepaid" all expenditures of that class on both incoming and outgoing shipments. At the close of each fiscal period the balance remaining in this account is written off as an operating expense.

A survey of the account for the past five years reveals the following facts:

Year	Debits	Credits	Write-offs
1930	$345,750	$342,000	$3,750
1931	298,500	294,700	3,800
1932	253,000	245,500	7,500
1933	258,750	242,000	16,750
1934	268,500	242,500	26,000

All charges are audited and approved by an "auditor," a clerk with a long record of trustworthy service, who neither handles cash nor draws cheques nor signs them.

(a) Discuss this procedure as it relates to the balance-sheet and earnings statement of the periods.

(b) In the circumstances would you consider it necessary or not to bring the matter to the attention of your client? Give your reasons.

No. 5 (15 points):

You are to certify the balance-sheet and income statement of the X Holding Company on a non-consolidated basis. In the course of the audit you find that its income account includes dividends from two wholly owned subsidiary companies which you do not audit. Concerning the latter you learn the following facts:

That subsidiary A had a net loss for the year but has had sufficient earned surplus since date of acquisition to cover the loss and the dividend paid; and

That subsidiary B had sufficient earned surplus at the date of acquisition to cover the dividend paid, but has suffered an earned-surplus deficit since, as well as a net loss for the year.

State in what manner, if at all, you will adjust the X Holding Company's balance-sheet or income statement, or how you will disclose the information you have obtained. Give your reasons in full.

No. 6 (9 points):

Auditing the books of the A Corporation in behalf of the X National Bank for credit purposes you find a substantial debit balance in an account entitled "Cash-surrender values." You learn that it appertains to policies in favor of the A Corporation on the lives of the principal officers.

(a) What steps will you take to verify this account?

(b) What information on this point will you give to the bank in your report?

(c) What, in particular, is it important for the bank to know? Why is it important?

No. 7 (5 points):

You have audited the accounts and certified the balance-sheet and earnings statement of the X Corporation for the year 1933. In 1934 the president of the corporation, knowing that you are suffering from lack of employment, offers you the privilege of selling a block of its stock on a commission basis. As a professional accountant will you accept the offer? Give your reasons.

No. 8 (10 points):

Corporation A, a trading company, owns all the stock of Corporation B, a real-estate holding company. Corporation B owns the real estate occupied by Corporation A for business purposes, subject to a mortgage which is owned by Corporation A. For the year ended Dec. 31, 1934, Corporation A pays rent of $4,000 to Corporation B, and receives from it interest of $6,000 on the mortgage and a dividend of $2,000 (from prior earned surplus) on the stock owned. Corporation B has a current net loss for the year of $4,000.

(a) State how you will report these facts for the income taxes of both corporations, and what the tax liability will be.

(b) If the same conditions had existed in 1933, what would the tax liability have been for that year?

No. 9 (15 points):

(1) What is "accounting control" as distinct from mere "ledger control"?

(2) State briefly how it may be applied in relation to:

(a) Plant and equipment

(b) Inventory

(c) Liabilities

(d) Income and expenses

(3) Is it always desirable? What could take its place in a control of a varied stock of supplies or retail merchandise?

No. 10 (10 points):

The A Corporation issued a million dollars face value of its own bonds at par in 1928. The terms of the bonds require the purchase of not less than 10% per annum of these bonds, which are to be deposited with a trustee and stamped "Held for sinking fund and not transferable." During 1934 the corporation purchased in the open market $100,000 par value of the bonds as follows:

$40,000 @ 98	$20,000 @ 120
30,000 @ 100	10,000 @ 130

and deposited them with the trustee.

State whether or not and to what extent, if at all, the difference between the issuing price and the purchase prices of the aggregate transactions should be reported in the corporation's federal income-tax return for 1934.

Accounting Theory and Practice—Part I

MAY 16, 1935, 1:30 P. M. TO 6:30 P. M.

Solve problem 1 or 2 and all other problems.

No. 1 (30 points):

The U. S. A. Company, a domestic corporation, purchased on January 1, 1931, a 90% interest in the capital stock of X Company, Limited, an English corporation, for the sum of $550,000. The U. S. A. Company acquired a further 5% interest in X Company, Limited, on June 30, 1932, for $25,000.

The following is a summary of the position of X Company, Limited, as shown by the reports of the local auditors:

	1931 January 1	1931 December 31	1932 December 31	1933 December 31
Current assets	£100,000	£110,000	£115,000	£125,000
Current liabilities:				
To U. S. A. Company (due in dollars)..	4,000 ($20,000)	6,250 ($25,000)	6,000 ($21,000)	4,000 ($20,000)
To others (due in sterling)	£36,000	£58,750	£69,000	£61,000
	£40,000	£65,000	£75,000	£65,000
Net current position	£60,000	£45,000	£40,000	£60,000
Fixed assets—less reserves	£75,000	£70,000	£65,000	£65,000
Funded debt	20,000	20,000	20,000	20,000
Net fixed position	£55,000	£50,000	£45,000	£45,000
Total equity	£115,000	£95,000	£85,000	£105,000
Capital stock	£100,000	£100,000	£100,000	£100,000

	1931 January 1	1931 December 31	1932 December 31	1933 December 31
Earned surplus*:				
Balance, January 1st	£15,000	£15,000	*£5,000*	*£15,000*
Profit or *loss* for year		*15,000*	*10,000*	20,000
Dividend paid June 30th		*5,000*		
	£15,000	*£5,000*	*£15,000*	£5,000
Total capital and surplus	£115,000	£95,000	£85,000	£105,000
Note: Earned surplus, June 30, 1932..			*£10,000*	
Exchange rates on balance-sheet dates	5	4	3.50	5
Do. on June 30th		5	4	

* Italics indicate red figures.

Prepare:

1. A columnar statement whereon the U. S. A. Company's entries to its investment and surplus accounts are shown. Give full explanations on the statement.
2. A statement of revenue surplus showing the ultimate profit or loss on exchange with proper explanation of how it came about.
3. State briefly in what manner the exchange risks could have been averted.

No. 2 (30 points):

From the following municipal trial balance at the close of a fiscal year but before closing the books, prepare a balance-sheet, properly subdivided into funds, after giving effect to necessary entries of the general fund and the sinking fund as of the close of the year and to settlements of all inter-fund balances other than permanent advances:

	Dr.	Cr.
Accounts receivable general fund...	$3,321.74	
Appropriation balances (unencumbered), general fund.............		$1,117.09
Assessments receivable	72,621.70	
Bond fund cash...................	2,005.60	
Bond fund balance (unencumbered).		678.00
Bonds payable, general capital account		250,000.00
Bonds authorized and unissued.....	8,000.00	
Contracts payable, bond fund.......		4,700.00
Due stores fund from bond fund...		1,277.60
Due stores fund from general fund.		1,593.96
Due stores fund from other funds..	2,821.56	
Estimated revenues................	1,500.00	
Fixed property....................	897,640.00	
Fixed property (income-producing, trust fund).....................	62,000.00	
General fund cash................	1,842.10	
Income account, sinking fund......		1,960.00
Interest account, special assessments	620.00	
Loan from general to stores and service fund....................	25,000.00	
Public benefit receivable (assessment fund)	6,400.00	
Reserve for encumbrances, general fund		2,827.10
Reserve for working capital.......		25,000.00
Reserve for retirement of bonds....		160,000.00
Reserve for uncollectible taxes.....		2,875.00
Sinking fund cash.................	1,450.00	
Sinking fund investments..........	160,000.00	
Sinking fund requirements.........	1,000.00	

	Dr.	Cr.
Sinking fund surplus..............		$490.00
Special assessment bonds..........		80,000.00
Special assessment fund cash.......	$1,872.65	
Stores and service fund working capital (loan from general fund)		25,000.00
Stores and service fund cash.......	1,408.22	
Stores inventory..................	15,942.80	
Surplus receipts, general fund......		896.00
Surplus, special assessment fund..		1,514.35
Surplus invested in fixed assets....		647,640.00
Taxes receivable, general fund....	6,972.61	
Temporary loans, general fund.....		3,000.00
Trust funds balance...............		96,320.00
Trust fund cash..................	6,820.00	
Trust fund investments............	27,500.00	
Vouchers payable, bond fund......		3,400.00
Vouchers payable, general fund....		1,327.30
Work in process, stores and service fund	4,827.42	
	$1,311,566.40	$1,311,566.40

No. 3 (20 points):

The December 31, 1934, trial balance of the Longwear Shoe Company before closing is as follows:

	Dr.	Cr.
Petty cash........................	$500	
The First National Bank..........	56,400	
Chicago store cash................	775	
Accounts receivable................	113,408	$1,260
Reserve for sales discount.........		4,800
Reserve for bad debts.............		15,000
Finished goods inventory..........	145,250	

	Dr.	Cr.
Materials and supplies	$271,800	
Office supplies inventory	1,600	
Chicago store inventory	11,700	
Prepaid insurance	2,800	
Land	5,000	
Buildings	156,000	
Reserve for depreciation—buildings		$92,000
Machinery	34,500	
Reserve for depreciation—machinery		26,000
Chicago store fixtures	4,400	
Reserve for dep'n.—Chicago store fixtures		3,700
Goodwill	100,000	
Accounts payable	355	37,500
Reserve for discount on inventory		4,050
Reserve for discount on accounts payable	1,750	
Accrued payroll		4,000
Reserve for taxes		5,600
Capital stock		200,000
Surplus		45,398
Sales		877,600
Purchase discount		13,000
Interest received		500
Sales discount	24,800	
Officers' salaries	20,000	
Office salaries	20,500	
Reserve for bad debts	7,700	
Office expenses	8,500	
Taxes	10,000	
Advertising	17,500	
Salesmen's salaries	13,400	
Salesmen's expenses	27,200	
Depreciation	6,570	
Taxes on building and machinery	4,000	

	Dr.	Cr.
Heat, light and power.............	$4,200	
Labor—foremen	17,500	
Labor—factory	212,700	
Lasts, dies and patterns............	8,200	
Machinery rentals and royalty......	16,000	
Repairs—factory	4,500	
Freight and cartage...............	1,200	
Sales—Chicago store..............		$16,080
Cost of sales—Chicago store......	9,040	
Depreciation of fixtures—Chicago..	440	
Salaries—Chicago	2,400	
Miscellaneous expenses—Chicago...	300	
Rent—Chicago	3,600	
	$1,346,488	$1,346,488

The average discount allowed on sales is 2%.

The average discount on purchases is 1%.

The actual inventories are as follows:

	Dec. 31, '33	Dec. 31, '34
Materials and supplies....	$99,000	$102,500
Finished goods...........	151,000	146,300
Office supplies...........	1,600	1,780
Chicago store............	12,200	12,618

The discount taken in January on December 31, 1934, balances of accounts payable was $750.

Depreciation has been adjusted monthly on the company's books and is correctly stated.

Prepare balance-sheet and profit-and-loss account for the year—the latter to show loss or gain from operations of the store separately. Do not adjust taxes or surplus and disregard cents.

No. 4 (15 points):

You are engaged to audit the books and accounts of a beet-sugar refining company for the fiscal year ended March 31, 1934.

All the sugar refined during the year ended on that date was manufactured from beets purchased from growers under participating contracts whereby the growers receive 50 per cent. of the average net proceeds from the sale of all the sugar. The contracts run from October 1, 1933, to September 30, 1934, and provide for final settlement with growers at the latter date. They specify that, if all the sugar manufactured from beets furnished under the contract is not sold prior to September 30, 1934, the settlement for the unsold portion shall be made on the basis of the prevailing market price on that date less estimated cost of selling.

The company purchased 750,000 tons of beets under contracts with growers during the fiscal year under audit and the average sugar content of the beets was 18 per cent. with a per cent. extraction of 81.5. At the close of the fiscal year you find the company has sold 1,500,000 hundred-pound bags of sugar manufactured from the beets purchased during the fiscal year and that the average net return per bag for the sugar sold was $3.75.

On March 31, 1934, the company has paid the growers a total of $5.00 a ton for all the beets purchased. This was considered a minimum base price which would not be reduced, regardless of the amount of net returns. Only the actual payments to growers have been included in the computation of manufacturing costs and no liability to growers appears on the books.

At the time of your audit, which takes place five months after the close of the fiscal year, the market price of sugar has risen and a substantial portion of the sugar remaining on hand at the close of the fiscal year has been sold. Based on the result of these sales and the condition of the market the company officers estimate that the sugar on hand at March 31, 1934, will yield an average net return of $3.90 per bag.

1. Determine the liability to growers, if any, as it will appear on the audited balance-sheet of the company as at March 31, 1934, and show your method of computation.
2. What note would you attach to the balance-sheet explaining the liability?
3. What change would you recommend to overcome the uncertainty involved in estimating the liability at the close of the fiscal year?

No. 5 (10 points):

On January 1, 1934, Corporation X had an authorized and issued capital stock of 100,000 shares without par value. Of the amount of $50 a share received from the sale of such stock the directors, under the provisions of the company's charter, had assigned $20 a share as the stated value and $30 a share as paid-in surplus. Under the laws of the state in which the company is incorporated the board of directors may apply part or all of the paid-in surplus to the reduction or extinction of any operating deficit or to the payment of dividends. On December 31, 1934, the company had an operating deficit of $2,000,000 and had in its treasury 40,000 shares of its capital stock which it had acquired by the payment of $24 a share in cash.

Disregarding any question as to the legality of the transactions which have been described, prepare a statement of stockholders' equity at December 31, 1934,

(a) on the basis of the given data.

(b) assuming that the company had an earned surplus of $250,000 instead of an operating deficit of $2,000,000.

State briefly the reasons for the procedure you adopt.

No. 6 (10 points):

The following is a statement of the assets and liabilities of the co-partnership of Deed and Seal as at January 1, 1930:

Assets	
Cash	$10,279.45
Investment in bonds	28,135.76
Accounts receivable	31,346.21
Inventory	44,281.95
Fixed assets (less depreciation, $2,973.06)	27,654.73
	$141,698.10
Liabilities	
Accounts payable	$37,602.19
Capital:	
Deed	73,605.74
Seal	30,490.17
	$141,698.10

The partnership was dissolved on June 30, 1930. Seal then withdrew and was paid out of the partnership funds his capital, as shown in the statement at January 1, 1930, less withdrawals, together with $8,000 in lieu of his share of profits for the year up to that date. Deed continued the business but on July 1, 1930, was joined in co-partnership by Escrowe who purchased from Deed a one-quarter interest in the partnership for $25,000, the profits thereafter to be divided in the proportions of two-thirds to Deed (his share in the former partnership) and one-third to Escrowe. The books of the old firm, kept by single entry, were not closed when Seal withdrew but were continued by Deed and Escrowe and at December 31, 1930, the following statement was prepared:

Assets

Cash	$17,963.28
Investment in bonds	15,178.33
Accounts receivable	36,524.29
Inventory	57,183.46
Fixed assets (less depreciation, $4,753.69)	43,465.37
	$170,314.73

Liabilities

Accounts payable	$47,982.17
Capital	122,332.56
	$170,314.73

Deed withdrew $1,000 a month; Seal had drawn $500 a month, and Escrowe withdrew $500 a month.

Particulars of the investment in bonds, as shown in the above statements, are as follows:

Cost of $25,000 6% bonds of OK and G Company, interest payable semi-annually, January 1st and July 1st....................................	$28,135.76
Less:	
Proceeds of $12,500 bonds sold June 30, 1930..	12,957.43
	$15,178.33

It has been agreed by the parties at interest that the income for the year 1930 is to be apportioned as follows: two-fifths (2/5) for the half year to June 30th and three-fifths (3/5) for the second half year, with the understanding that the loss from the sale of the bonds is a charge against the income of the first half of the year.

Prepare a statement of the three partners'-capital accounts and show how you determine the profits.

No. 7 (10 points):

The Dimenslot Company maintains a branch office in a distant city where the only financial transactions authorized are the collection and deposit in bank of receipts from automatic vending machines, the payment of branch payrolls and expenses and the remittance to the factory of funds in excess of branch requirements. Monthly reports of cash receipts and disbursements are sent to the factory.

In conducting an audit of the factory for a fiscal year ended June 30th, the auditor forwarded the twelve monthly cash reports to his representative in the city where the branch was located, with the request that they be compared with the records maintained at the branch and that such records be audited. In due course he received a report from his representative stating that the monthly reports were in agreement with the books and that the balance in bank at the end of the year had been verified directly with the depository. The representative also stated that the deposits as shown by the bank statements and the cheques issued by the branch exceeded, respectively, the receipts and disbursements shown by the books. Such excess, he stated, consisted of contra items, and he included, without further comment, the following summary of disbursements not appearing on the monthly reports and the branch books.

	(1) Bank loans, subsequently renewed	(2) Cheques returned, subsequently redeposited	(3) Cheques to employees	(4) Accommodation purchases
July	$4,600.00	$20.45	$58.24	
August		200.00	400.00	$271.80
September ...		15.00		707.84
October	4,600.00	37.25		750.00
November ...			5.00	
December ...	3,000.00	60.00	223.40	156.00
January			300.00	
February			620.00	
March			200.00	
April				
May		23.50		
June			335.55	203.35
	$12,200.00	$356.20	$2,142.19	$2,088.99

What do you understand from each of the four numbered columns?

What would be the contra items for each of these classifications?

If you were the auditor, what objections would you have to the report made by the representative?

How would you dispose of this matter so far as your client is concerned?

No. 8 (5 points):

The City of Noware owns and operates the electric light plant serving the city. Bonds maturing in 20 years were issued to acquire the plant and, in terms of the issue, a sinking fund must be established by equal annual cash instalments to provide for the retirement of the bonds at maturity. Adequate depreciation is provided out of the revenue but it is alleged that, inasmuch as the taxes to be levied must include the annual sinking-fund payments, the amount thereof should be charged against the operations of the utility. If this is not done, it is argued, the earnings of the utility will be overstated by the amount of the sinking-fund contributions.

1. What is your opinion? Give reasons.
2. What should be done in case the trust deed under which the bonds were issued explicitly states that the sinking fund is to be charged against the operations of the utility?

Commercial Law

MAY 17, 1935, 9 A. M. to 12:30 P. M.

Reasons must be stated for each answer. Whenever practicable, give the answer first and then state reasons. Answers will be graded according to the applicant's evident knowledge of the legal principles involved in the question rather than on his conclusions.

Group I

Answer all questions in this group.

No. 1 (10 points):

Plaintiff made a written contract with defendant, a newspaper, whereby plaintiff agreed to become a passenger on an airship from a foreign country to the United States and during said passage to send radio messages to friends in reply to messages sent to plaintiff by said friends. Plaintiff's radio messages were to be reports of the flight which defendant was to publish and for which defendant agreed to pay plaintiff $5,000. Both plaintiff and defendant knew that plaintiff had agreed with the airship company as a condition of his being carried as a passenger that he would send no radio reports of the passage and both plaintiff and defendant knew that a third person had the exclusive news rights. Plaintiff fully performed his part of the contract. Can he compel defendant to pay him the $5,000?

No. 2 (10 points):

(a) In a transaction in which an owner of real property mortgages it upon obtaining a loan, describe all of the rights which the mortgagee acquires.

(b) What remedies does the mortgagee have for the enforcement of his rights?

(c) Define and explain equity of redemption.

No. 3 (10 points):

The maker of a valid promissory note legally procured defendant's endorsement prior to delivery of the note to the payee. Prior to maturity, the payee orally agreed with defendant and with the maker to release defendant as endorser and in consideration therefor defendant turned over certain valuable property to the payee. There was no written renunciation by the payee of his rights against defendant as endorser and the note was neither surrendered nor in any way marked or altered. Was defendant released as endorser so far as the payee is concerned?

No. 4 (10 points):

One joint adventurer began an action at law against his co-adventurer for money damages for alleged preventable losses sustained in the joint venture. Many items of debit and credit were in dispute between them. Was the action properly brought? If not, what remedy should the plaintiff have sought?

No. 5 (10 points):

Describe and explain the following terms so as to differentiate them:

(a) Agent.
(b) Servant.
(c) Employee.
(d) Independent contractor.
(e) Broker.

Group II

Answer any five questions in this group. No credit will be given for additional answers, and if more are submitted only the first five will be considered.

No. 6 (10 points):

Edward Engle and several other members of a club had endorsed a note made by the club. The club failed to pay the note and the payee procured from the president of the club a list of names and addresses of endorsers. This list was typewritten on club stationery which showed Engle's name as secretary and his address. The payee attempted to verify the addresses by examining the current telephone directory in which he found an Edward Engle at an address different from the one on the club stationery. Within the legally proper time the payee sent a notice in legally proper form to Edward Engle by registered mail at his address as stated on the club stationery. Two days later the post office returned this notice with a notation "Moved, left no address." Was the payee's notification of Engle sufficient to hold Engle as endorser?

No. 7 (10 points):

(a) Can a partnership be created in any way other than by express contract? If so, give an example.

(b) List (but do not discuss) the various causes for dissolution of a partnership otherwise than in accordance with provisions of the contract or articles of partnership.

No. 8 (10 points):

At a conference in the office of the Simpson Corporation, a duly authorized representative of the Tompkins Corporation arranged orally with a duly authorized representative of the Simpson Corporation for the Tompkins Corporation to sell to the Simpson Corporation merchandise of the value of $1,000. The representatives then prepared a memorandum of this sale on a Simpson form used by that corporation in selling merchandise to its customers, because the Tompkins representative had with him no order blanks of his own. At the top of the form the Simpson Corporation's name and address were printed. The name of the Tompkins Corporation was written on a blank line following the words "Sold to," and that corporation's address was written following the word "Address." These items and a description of the merchandise sold and the terms of the sale were written on the form by the Tompkins representative. Did the name of the Tompkins Corporation thus written constitute its signature under the statute of frauds?

No. 9 (10 points):

How can a director of a corporation protect himself from possible liability when a majority of the board adopts a resolution which he believes to be wrong (a) when he is present at the meeting, and (b) when he is absent from the meeting?

No. 10 (10 points):

What is cumulative voting? For what purpose is it employed? How does it accomplish its purpose?

No. 11 (10 points):

(a) Who may become a voluntary bankrupt?

(b) Who may be adjudged an involuntary bankrupt?

(c) Name at least four acts of bankruptcy.

No. 12 (10 points):

(a) In an ordinary bailment, what are the duties of a bailee for hire with respect to the custody and care of the bailor's property?

(b) Does a bank which holds corporate stocks pledged on a collateral loan have the same duties as a bailee for hire? If not, what are the differences?

(c) List the most important provisions of a bill of lading which is negotiable.

Accounting Theory and Practice—Part II

MAY 17, 1935, 1:30 P. M. TO 6:30 P. M.

Solve all problems.

No. 1 (25 points):

On December 31, 1933, a line of freighters—8 vessels of 6,000 tons, each costing $640,000 to build, or together $5,120,000, has outstanding $3,500,000 of capital stock, on which 11% was earned in 1933, after providing 5% for depreciation. It is assumed that thereafter each vessel will have the same gross earning capacity as in 1933, until it becomes obsolete after 20 years' regular operation. The vessels will not be replaced but will be sold at junk value at that time. No surplus or excess cash is allowed to accumulate, all funds in excess of requirements being distributed to the shareholders.

As the vessels grow older, the annual repair and maintenance costs increase as follows:

Up	to	5	years	old	1%	of	original	cost
"	"	10	"	"	2%	"	"	"
"	"	15	"	"	3%	"	"	"
"	"	20	"	"	4%	"	"	"

On December 31, 1933, the eight vessels owned are:

4– 3	years	old
2–10	"	"
2–12	"	"

The line is offered on that date three similar vessels, respectively 8, 14 and 16 years old, for $880,000, payable in 6% bonds that fall due serially on December 31st of each succeeding year to the amount of the depreciation accrued in that year on the three vessels.

1. Prepare a statement showing the financial advantage or disadvantage of the purchase for each year in which any of the three vessels are operated.

2. What would be the advantage or disadvantage to the original shareholders (not to the company) in financing the purchase by the issue of common stock at par value?

No. 2 (20 points):

G and H are domestic companies whose audited balance-sheets of December 31, 1934, are as follows:

Assets	G	H
Cash	$15,000	$2,500
Accounts receivable—good and collectible	14,000	19,000
Marketable securities:		
Owned by Company G (market value $10,000)	18,000	
Owned by Company H (market value $27,000)		27,000
Investment in Company K (wholly owned) represented by 5,000 shares—at cost (market value $1,000,000)	500,000	
Investment in H—book value (120 shares)	1,200	
Investment in G—book value (800 shares)		80,000
	$548,200	$128,500

Liabilities		
Accounts payable....................	$15,000	
Capital:		
6,000 shares, par value $100.........	600,000	
10,000 shares, par value $10..........		$100,000
Surplus		28,500
Deficit (italics indicate red figure)....	*66,800*	
	$548,200	$128,500

Under a plan of reorganization the Companies G and H are to be merged at December 31, 1934, to form a company J with an authorized capital of $2,000,000 representing 20,000 shares of $100 each. All shareholders agree to the merger except X who owns 100 shares of G and 2,000 shares of H. However, X will accept for his interest in the two companies an equivalent amount of company K shares at their market value. He will receive cash for any fractional part of a company K share.

The other shareholders will receive company J shares at their par of $100 each. They will pay or receive cash in lieu of fractional J shares and it is intended to pay out the smallest amount of cash to each of the two groups of company G and H shareholders.

1. How many shares of company K and how much cash are distributable to X?
2. How many shares of company J and how much cash are distributable to each of the two groups of shareholders G and H?
3. Prepare the opening balance-sheet of company J.

No. 3 (15 points):

State whether you agree with the following propositions and give the reasons for your opinion:

1. The accountant is and should be responsible for a correct valuation of inventories of materials, merchandise and supplies.
2. The accounts of all companies in which more than 51% of the voting stock is owned or controlled by the parent company should be included in a consolidation.
3. Any accounting principles which are prescribed by the United States Bureau of Internal Revenue for the preparation of income-tax returns should be followed in the books of the company and in any statements prepared therefrom.

No. 4 (15 points):

The Eastern Company, the Southern Company, and the Western Company are consolidated by the following method:

1. A new corporation, the Northern Company, is formed.
2. The Northern Company takes over all the assets and assumes all the liabilities of the three consolidating companies, paying for them as follows: To the preferred stockholders of the old companies, first-mortgage bonds of the new company at par. The total authorized bond issue is $400,000.

To the holders of common stock:

In the Eastern Company—30 shares of new stock for each share of old stock.

In the Southern Company—10 shares of new stock for each share of old stock.

In the Western Company—20 shares of new stock for each share of old stock.

3. The new company (the Northern Company) is capitalized at $1,000,000. (100,000 shares of a par value of $10 each.)
4. All properties are to be taken over at their book values.
5. The old companies are to be dissolved.

On the date of consolidation the balance-sheets of the three combining companies were as follows:

Assets	Eastern Company	Southern Company	Western Company
Land	$600,000	$30,000	$20,000
Buildings	20,000	100,000	25,000
Machinery and equipment..	250,000	125,000	10,000
Inventories	75,000	100,000	20,000
Notes receivable	10,000		
Accounts receivable	165,000	325,000	160,000
Cash	30,500	35,000	15,000
Prepaid insurance, etc.....	2,500	1,500	500
	$1,153,000	$716,500	$250,500
Liabilities and Net Worth			
Preferred stock—par $100..	$300,000	$50,000	$50,000
Common stock—par $100..	200,000	300,000	50,000
Notes payable	50,000	50,000	
Accounts payable	69,000	158,500	70,500

Liabilities and Net Worth	Eastern Company	Southern Company	Western Company
Accrued taxes	$5,000	$3,000	$1,000
Unpaid wages	20,000	10,000	2,000
Reserve for depreciation:			
Building	4,000	20,000	5,000
Machinery and equipment	30,000	45,000	2,000
Surplus	475,000	80,000	70,000
	$1,153,000	$716,500	$250,500

The Western Company owed the Southern Company $24,000 on open account.

The $10,000 notes receivable of the Eastern Company represent notes of the Southern Company.

Prepare the balance-sheet of the Northern Company after the consolidation has been effected.

No. 5 (10 points):

You have been asked to make an examination of the accounts of a National Bank as at the close of its fiscal year and render a report to its board of directors.

A statement of the bank's earnings and expenses as published is as follows:

Earnings	
Discount earned	$1,000,000
Interest on investments............................	1,750,000
Profit from sales of securities after considering a previous charge-off in the value of such securities to reserve for contingencies of $150,000...........	50,000
	$2,800,000

Expenses

Expenses	$1,200,000
Interest on time accounts	500,000
Taxes (federal and state)	250,000
Uncollectible loans	50,000
Reserve for contingencies	500,000
	$2,500,000
Net earnings	$300,000

In addition, you find that there has been (1) an appropriation or transfer of $2,000,000 from undivided profits to reserve for contingencies, (2) a write-down of $1,000,000 in the value of securities charged against that reserve and (3) a further charge of $1,000,000 against the reserve to cover actual loans considered worthless during the year.

In preparing your report what would you state to be the year's net earnings or loss which you would certify? Prepare a summary of the earnings statement.

No. 6 (10 points):

The Idaho Company has outstanding on January 1, 1933, 1,500 shares of common stock, par value $100, owned as follows:

James Owen	600 shares
Arthur Black	200 "
Fred Jensen	300 "
Thomas Carlyle	400 "

The surplus and reserves on the above date were: Surplus, $50,000 and reserve for bond sinking fund, $25,000.

During the year the company declared and paid a 4% dividend in June and declared a 4% dividend on

December 20, 1933, payable January 10, 1934. The profits were $20,000, after depreciation, and $6,000 was charged to surplus as an addition to the sinking-fund reserve.

On January 1, 1934, the company purchased one-half of Carlyle's stock at book value, and sold it on January 10th to Otto Seltzer for $190 a share.

During 1934 the company declared and paid a dividend of 9%. Its operating profits were $25,000 after depreciation. The accountant set up a reserve of $2,000 and the directors asked that the following amounts be added to the reserves: $4,000 for possible market declines in inventories, $10,000 for extension of plant and $3,000 for sinking fund.

1. Prepare journal entries for the purchase and sale of the stock in January, 1934.
2. Prepare a statement showing how the book values of the stock on December 31, 1933 and 1934 should be calculated.

No. 7 (5 points):

Following is a summary of the endowment funds of the State University:

Aggregate of the funds at July 1, 1933......			$5,500,000
Increases:	Sept. 1, 1933....................	$15,000	
	Oct. 1, "	50,000	
	Jan. 1, 1934....................	85,000	
	Mar. 1, "	100,000	
	May 1, "	25,000	
			275,000
Aggregate at June 30, 1934................			$5,775,000

Included in the endowment funds is a fund for the Dowd Chair of Chemistry, viz.:

Balance of fund at July 1, 1933			$75,000
Increases:	Oct. 1, 1933	$5,000	
	Jan. 1, 1934	15,000	
	May 1, 1934	10,000	
			30,000
Aggregate at June 30, 1934			$105,000

The total income for the year ended June 30, 1934, earned from the investment of all the funds, is $275,750.

Assuming that the securities in which the funds are invested are pooled:

1. What is the average rate of income earned during the year ended June 30, 1934?
2. What amount of the income must be applied toward the expenses of the Dowd Chair of Chemistry?

Examinations of November, 1935

Auditing

NOVEMBER 14, 1935, 9 A. M. TO 12:30 P. M.

The candidate must answer the first nine questions and either question 10 or question 11.

No. 1 (5 points):

How should receivables representing accounts due in instalments maturing later than one year after date of the balance-sheet be shown on a statement prepared for seeking a three months' loan from a bank? Give your reasons.

No. 2 (15 points):

State briefly your understanding of the meaning in accountancy of the following terms:

Working fund
Fund balance-sheet of a municipality
Debenture
Escrow
Hypothecation
Depreciation
Obsolescence
Amortization.

No. 3 (5 points):

In a detailed audit you find that the item "deferred charges," shown in one aggregate amount on the balance-sheet, comprises discounts on financing, deferred development, advertising and sundry operating expenses. How will you treat this in your report?

No. 4 (5 points):

Entering upon the audit of the A B Corporation you discover that in accordance with its usual custom it has held open its books for fifteen days after the end of its fiscal year and has entered, as of the closing date of said year, the collections of open accounts and cheques drawn in payment of purchase and expense bills, bearing dates prior to the end of the year. No other transactions during the fifteen days are so entered.

Discuss the probable reason for and the effect of this procedure, and state what action you would take in the matter. Give your reasons.

No. 5 (5 points):

In the accounts-payable item on the balance-sheet accountants rarely segregate those past due. Do you think this should be done? Give your reasons, pro and con.

No. 6 (10 points):

The A B Corporation offers you an engagement to make a detailed audit of its books and accounts, your fee to be paid in stock of the corporation at par. For some time the stock has been quoted above par on the local exchange.

State whether or not you would accept such an engagement, and why.

No. 7 (15 points):

Describe how you would proceed in the audit of a bank to verify (a) cash on hand and in other banks amounting to $2,000,000; (b) the collateral loans; and (c) the bank's own investments.

No. 8 (20 points):

The X Corporation desiring additional capital submits to an investment company a statement in which the "net income for 1934 available for dividends" is shown as $65,000.

You are engaged by the investment company to audit the books of the X Corporation for the purpose of verifying this net income. Your audit discloses the following facts which are not shown in the statement, viz.:

(a) Depreciation for the year amounting to $16,000 was not provided;

(b) Dividends of $25,000 on preferred stock were payable on the day following the date of the statement;

(c) A machine manufactured by the corporation for its own use at a cost of $12,000 was charged to machinery account at the market price of similar machines, namely, $17,000;

(d) In accordance with the terms of a trust deed under a bond issue $15,000 should have been credited out of net income to a sinking fund reserve;

(e) There was included in the net income $12,000 derived from non-recurring transactions apart from the usual business operations;

(f) No provision was made for the 1934 federal income tax.

Explain how each item should have been treated on the books or on the statement, and prepare summaries showing (a) the correct net earnings and (b) the net income available for dividends.

No. 9 (10 points):

A corporation has been in business for many years and both business and plant facilities have been continually expanded. It has regularly made good profits and accumulated a large surplus which is shown without explanation on the balance-sheet as a single item.

At an annual meeting the stockholders complain that their dividends have not been commensurate with the prosperity of the corporation as shown by the annual statements, and the president explains vaguely that while most of the surplus is legally available for dividends, there are practical reasons why it can not be distributed at the present time. Not satisfied with this explanation the stockholders thereupon engage you to make an examination and analysis of the surplus account and report thereon.

Assuming that the president's explanation is correct, state what you would expect to discover and report.

No. 10 (10 points):

In 1914 the A Corporation leased property consisting of land, buildings erected thereon and machinery installed therein to the B Corporation for 99 years. Inter alia the lease provided that the property should be returned to the lessor at the termination of the lease in as good condition as when leased and also that any improvements made by the lessee should become the property of the lessor upon termination of the lease.

In 1924 the lessee made extensive additions to the buildings and also scrapped some of the machinery, replacing it with modern equipment at a greater cost than that of the original units leased.

In 1934 the lease was terminated by breach and the lessor came into possession of the property.

What is the federal-income-tax status of the A Corporation in 1934 in respect to

(a) the additions to the buildings and

(b) the improvements to the machinery

made by the B Corporation?

Explain your answers.

No. 11 (10 points):

What are the general advantages of monthly balance-sheets, profit-and-loss and operating statements (a) if prepared by the bookkeeper and (b) if prepared or audited by a public accountant?

Accounting Theory and Practice—Part I

NOVEMBER 14, 1935, 1:30 P. M. TO 6:30 P. M.

Solve problem 1 or 2, problems 3, 4 and 5 and problem 6 or 7.

No. 1 (30 points):

A public service corporation about to issue $53,000,000 first mortgage bonds, to be dated July 1, 1935, and due July 1, 1965, sought bids from underwriters which narrowed down to two:

(1) "A" offers for itself and others for 3½% coupon bonds 101.913 per cent. of par, the company to receive $54,013,890.

(2) "B" offers for itself and others for 3.4 per cent. coupon bonds 100.417 per cent. of par, the company to receive $53,221,010.

The legal and accounting expense of the company applying to the issue is $300,000. Interest is payable semi-annually on January 1st and July 1st.

The company has outstanding an issue of non-callable, three-year 5% coupon notes dated April 15, 1933, due April 15, 1936, amounting to $16,000,000, interest on which is payable semi-annually. The current market price of these notes is 103 and interest.

After awarding the issue to A for offer (1), the president of the company issued the following announcement:

"The management has recommended and the directors have approved the sale of $53,000,000

> par value, first mortgage 3½% bonds to "A" which bid 101.913 per cent. to the company. . . .
>
> "The management and directors gave long and serious consideration to offer (2) of "B," carrying a 3.4 per cent. coupon. Although this would mean an interest saving of $53,000 a year over the 30-year life of the bonds the premium offered amounted only to $221,010 as compared with a premium of $1,013,890 in offer (1) of A. The receipt of nearly $800,000 in additional money at this time would be a great advantage to the company in further reducing the short-term debt still outstanding after the completion of this issue. The management is strongly of the opinion that this advantage more than offsets the interest saving under the lower coupon rate."

Assuming you had been asked to help the directors in awarding the bid, what reasoned opinion would you have given?

Note.—The calculations in this problem may be made either by arithmetic or by actuarial methods.

On the basis of 3½% interest per annum, payable semi-annually:

Present value of $1 payable after 60 half yearly periods	$.35313
Present value of $1 per annum over 60 half yearly periods	$36.96399

No. 2 (30 points):

The following statement gives the account balances on the books of a college at the end of the fiscal year before closing:

	Debit	Credit
General current funds		
Cash	$17,000	
Investments	20,000	
Accounts receivable	3,000	
Inventories	18,000	
Estimated income	1,385,000	
Appropriations		$1,360,000
Accounts payable		2,000
Reserve for working capital		20,000
Unappropriated surplus (after entering budget)		111,000
Educational and general expenditures	1,060,000	
Auxiliary enterprises expenditures	252,000	
Other non-educational expenditures	26,000	
Educational and general income		1,070,000
Auxiliary enterprises income		315,000
Other non-educational income		15,000
Transfer to endowment	50,000	
Transfer to plant funds	62,000	
	$2,893,000	$2,893,000
Restricted current funds		
Cash	$3,000	
Investments	58,000	
Accounts payable		$1,000
Fund balances		60,000
	$61,000	$61,000
Loan funds		
Cash	$1,000	
Investments	5,000	
Notes receivable	36,000	
Income		$2,000

Funds principal beginning of year....		$25,000
Gifts to loan funds during year....		15,000
	$42,000	$42,000
Endowment and other non-expendable funds		
Cash	$3,000	
Securities	857,000	
Funds in trust..........................	100,000	
Profit on sales of investments......		$10,000
Endowment funds principal beginning of year............................		700,000
Gifts to endowment..................		100,000
State tax collections for endowment..		100,000
Transfer from current funds (temporary)		50,000
	$960,000	$960,000
Funds subject to annuities		
Cash	$1,000	
Investments	99,000	
Fund balances, beginning of year....		$80,000
Gifts of annuity funds..............		20,000
	$100,000	$100,000
Unexpended plant funds		
Cash	$4,000	
Investments	15,000	
Expenditures for plant additions....	360,000	
Replacement funds balances..........		$15,000
Plant additions funds balances, beginning of year..................		50,000
State appropriation for plant additions		200,000

Gifts for plant additions		$50,000
Income on investments		2,000
Transfer from current funds		62,000
	$379,000	$379,000
Funds invested in plant		
Educational plant, beginning of year	$3,100,000	
Bonds payable		$100,000
Investment in plant		3,000,000
	$3,100,000	$3,100,000
Agency funds		
Cash	$2,000	
Investments	8,000	
Fund balances		$10,000
	$10,000	$10,000

Attention is called to the following facts and conditions which are disclosed upon examination of the records:

(1) Notes of loan fund amounting to $500 are found to be uncollectible and are to be written off.

(2) An annuity fund of $1,000 for current purposes has matured through the death of the annuitant.

(3) Included in the educational expenditures of the year from current funds is the sum of $14,000 for new equipment.

(4) Equipment included in plant assets at beginning of year to the amount of $32,000 had worn out or other disposition of it had been made.

(5) Orders and contracts outstanding at close of year and payable from current funds appropriations amounted to $6,000.
(6) An analysis of endowment funds shows that at the beginning of the year $200,000 included therein represent undesignated funds temporarily functioning as endowment.
(7) A further analysis indicates that $100,000 of endowment funds has been expended for a residence hall, the value of which is included in plant assets but not in endowment funds.
(8) Income and expenditures of restricted current funds are included in the budget estimates and in the totals of income and expenditure carried in the general-funds section.

You are required:
- (a) To make the necessary closing entries in all funds.
- (b) To prepare a balance-sheet after closing.
- (c) To prepare a statement of current income, expenditures and surplus for the year.

No. 3 (25 points):

The capital of the co-partnership of Goe & Gettem amounted to $40,000, of which Goe contributed $25,000 and Gettem $15,000. The arrangement with respect to the distribution of profits was that Goe received 60% and Gettem 40%. The capital contributions referred to represented the amount of the capital of the respective partners immediately prior to the admission of Goode as a partner on January 1, 1933.

By agreement among the three partners the aggregate contributed capital of the new firm at its inception on January 1, 1933, was to continue at $40,000, Goode to pay to Goe, personally, $10,000 for the transfer from Goe's capital account to Goode's capital account of a one-quarter interest and Goode to have a 20% interest in the profits or losses, thus making the interests in profits and losses of Goe and Gettem 40% each.

The profits for 1933 amounted to $15,000 and during the year Goe withdrew $7,000, Gettem $5,000 and Goode $2,500. A loss of $25,000 was sustained in 1934 and the withdrawals during that year were: Goe $4,000, Gettem $3,000, Goode $2,000. Goode had advanced $1,000 as a loan and the other liabilities at December 31, 1934, consisted of trade accounts payable.

When it was decided at the end of 1934 to liquidate, the trade creditors were paid in full from the cash on hand and the collections of accounts receivable. Of the then remaining $7,500 assets $6,500 were sold for $1,500 cash. It was agreed that this cash should be distributed before realization of the sole remaining asset of $1,000, the value of which was problematical. Assuming that Goe and Gettem may have to absorb any deficiency on Goode's accounts—

1. How should the $1,500 cash be distributed?
2. How should the proceeds from the sale of the doubtful asset be distributed if $800 is ultimately realized?
3. How if $5,000 is ultimately realized?

4. What is the amount that should be realized so that Goode's share may exactly reimburse his partners for the deficiency assumed by them?

No. 4 (20 points):

The Roane Realty Company purchased a sixty-acre tract of land (43,560 square feet to an acre) for $24,000 and spent $91,620 for improvements and expenses. Of the acreage 701,100 square feet were used for streets, parkways, alleys, etc.

No sales were made during the first year. During the second year lots were placed on the market and sales were made based on two classes. One-third of the land was placed in a class called "A" and the balance was classed as "B." The lots were of equal size and contained 12,750 square feet each. The price was 8¢ per square foot for class A and 7¢ per square foot for class B lots, with discount of 10% on all sales for cash.

In the second year 10 class A and 17 class B lots were sold. Four of the ten sales of class A, and six of the seventeen sales of class B were for cash. The other sales were on the basis of 10% cash and nine additional equal payments.

During the third year all the other lots were sold. Ten class A and twenty-five class B lots were sold for cash; the rest on the ten-payment plan.

Profit is to be considered as earned and unearned. Earned profit is that part of the profit that is realized by actual collection. At the end of the second year (the first year of sales) there was still due on instalment sales an average of four instalments which were paid in the third year. At the end of the third year there was an average balance on instalment sales of three payments, all good and collectible.

State the earned profit for each of the two years in which sales were made. Carrying charges need not be considered.

No. 5 (15 points):

John Gibbon died January 1, 1930, and left his property in trust to his daughter Ethel. The income was to be paid to her as long as she lived and at her death the trust was to go to his nephew, William Gibbon. He appointed John Doe trustee at a fixed fee of $5,000 per annum. All expenses of settling the estate were paid and accounted for by the executor before the trustee took it over.

Ethel died on September 30, 1933, and left all her property in trust to her cousin, Joseph Hart. John Doe was appointed executor and trustee of her estate and he agreed not to make any additional charges for these services. All income was to be paid to Joseph Hart. The estate, which consisted solely of Ethel's unexpended income from the John Gibbon trust, was immediately invested in 4% certificates of deposit.

The property received under the will of John Gibbon on January 1, 1930, was:

10,000 shares of the K. O. Corporation, valued at $100 each.
$300,000 bonds of the K. O. Corporation, paying interest on June 30th and December 31st at 6% per annum.

In the five years ended December 31, 1934, the trustee received the following dividends on the stock:

February 1, 1930	$40,000
" " 1931	40,000
" " 1932	40,000
" " 1933	60,000
" " 1934	60,000

and he made the following payments:

Expenses:		
$100 a month, totaling		$6,000
Trustees fees:		
$5,000 per annum, totaling		$25,000
To beneficiaries:		
Ethel Gibbon		
1930	$27,250	
1931	35,000	
1932	25,000	
1933	37,000	$124,250
William Gibbon		
1933	$17,000	
1934	46,000	$63,000
Joseph Hart		
1934		$3,000

The surplus income was left on deposit in the bank and drew no interest.

Prepare trustee's accounts covering the five years ended December 31, 1934, showing the beneficiaries' interests.

No. 6 (10 points):

On April 30, 1935, the X Y Z Corporation, a newly organized holding company, acquires all of the outstanding capital stocks of Companies A and B (the latter company owning the entire outstanding capital stocks of Companies C and D) by issuing all of its own stock share for share to the stockholders of Companies A and B.

It is established that:

(1) The earned surplus of Company A on April 30, 1935, was....................................	$150,000
(2) The earned surplus of Company B (including $85,000 representing the combined earned surplus accounts of Companies C and D on the dates they were acquired by B) was....................	235,000
(3) None of the companies A, B, C or D had a capital surplus on April 30, 1935............	
(4) The combined earnings of all companies for the two months ended June 30, 1935, were........	60,000

Question A

How would you deal with the above items in the June 30, 1935, balance-sheet of the X Y Z Corporation?

You are called into consultation by the directors of the X Y Z Corporation on July 15, 1935. They inform you that they wish to continue dividends of the same amount that the original stockholders of the subsidiary companies have been receiving regularly and that such amount would be $200,000.

Question B

State briefly the advice you would give them. You may assume that the earnings of Companies A and B and also the dividends paid to their respective stockholders have been equal.

No. 7 (10 points):

Company A owns 80% of the capital stock of each of the companies B and C. Company B owns 90% of the capital stock of Company D. Company C owns 95% of the capital stock of Company E. Company D sells to Company E real estate costing $100,000 for $150,000 cash.

On the assumption that there was justification for the sale of the real estate and that the selling price was the fair market value at the time of the sale, show how the profit of $50,000 is to be treated in the consolidation of—

(1) Company B and its subsidiary, Company D.
(2) Company C and its subsidiary, Company E.
(3) Company A and its subsidiaries, Companies B and C.

Commercial Law

NOVEMBER 15, 1935, 9:00 A. M. TO 12:30 P. M.

Reasons for each answer must be stated. Whenever practicable give the answer first and then state reasons. Answers will be graded according to the applicant's evident knowledge of the legal principles involved in the question rather than on his conclusions.

Group I

Answer all questions in this group.

No. 1 (10 points):

The Printing Company contracted with the Cook Company to supply stationery to the latter during a stated period, on a cost-plus basis. The contract defined cost as "actual cost of labor and material (including an amount of administrative and overhead charges, attributable to the performance of said agreement, satisfactory to the Cook Company, which said sum is to be determined by the Cook Company after an audit and examination by the Cook Company of the books and accounts of the Printing Company)." The Cook Company, after its audit, notified the Printing Company that the overhead charges made by the latter were not satisfactory to the Cook Company. The dissatisfaction was actual and not capricious but was based on points in dispute among outstanding accountants. Is the Printing Company conclusively bound by the Cook Company's position?

No. 2 (10 points):

A stockholder, exercising a legal right to inspect the financial books of account of the corporation, brought with him a public accountant to advise him in the examination and to make transcripts from the accounts to be taken away by the stockholder. The corporation's officers refused to permit the public accountant to see the accounts or to make transcripts therefrom. Were they justified in their refusal?

No. 3 (10 points):

John Barton was 19 years old and employed as a bookkeeper. He subscribed to a non-cancellable correspondence course in accountancy for which he agreed to pay a stipulated amount. He completed half of the course, paid one-quarter of the stipulated amount, and thereupon, at the age of 20, refused to continue the course or to make further payments. What are the rights of the parties?

No. 4 (10 points):

In June, 1929, Herman was an internal-revenue agent entitled to certain pension and retirement rights. On July 1, 1929, at the instigation of the X Corporation, he resigned and entered the employ of the X Corporation under a written contract which provided that during the rest of his life he was to devote his entire time to the corporation as assistant to the president, for which he was to be paid a salary of $5,120 per annum. On November 13, 1929, the X Corporation discharged him without cause. Assuming that no question of ultra vires was involved, what are his rights under the contract?

No. 5 (10 points):

(a) Define personal property.
(b) Define tangible and intangible.
(c) Define lien.
(d) Define pledge.
(e) What are the usual ways by which title to personal property is acquired?

Group II

Answer any five questions in this group. No credit will be given for additional answers, and if more are submitted only the first five will be considered.

No. 6 (10 points):

Mason and Dana were negotiating and Mason's attorney prepared a long and carefully drawn contract which was given to Dana for examination. Five days later and prior to its execution, Dana's eyes became so infected that it was impossible for him to read. Ten days thereafter and during the continuance of the illness Mason called upon Dana and urged him to sign the contract, but without in any way misrepresenting the contents of it, and Dana signed without reading it. In a subsequent suit by Mason, Dana claimed that the contract was not binding upon him because he had not and could not have read it prior to his signing it. Is Dana's claim a valid defence?

No. 7 (10 points):

In what respects must a negotiable instrument be changed in order that the change will constitute a material alteration?

No. 8 (10 points):

In the absence of any applicable statute, what is a testamentary trustee's duty as to (a) amortization of premiums on bonds purchased by him, (b) amortization of premiums on bonds purchased by the testator and acquired by the trustee as a part of the trust fund, (c) accumulation of discounts on bonds purchased by the trustee?

No. 9 (10 points):

The Surety Company was a duly organized corporation engaged in the business of issuing surety bonds. In consideration of its regular fee, it became surety on the official bond of a municipal treasurer. The treasurer defaulted and the municipality took his six-months note for the amount of the shortage, but the Surety Company was not notified. The treasurer failed to pay the note at its maturity and the municipality sued him and the Surety Company for the amount of the shortage. Upon trial it appeared that there had been no substantial change in the treasurer's financial condition during the interval between the discovery of the defalcation and the starting of the suit. Was the Surety Company discharged from liability when the municipality accepted the treasurer's note?

No. 10 (10 points):

One of the maxims in equity is: "He who comes into equity must come with clean hands." State briefly the other principal maxims but do not elaborate upon or discuss them.

No. 11 (10 points):

(a) What are the principal kinds or types of insurance?

(b) What is the legal reason why insurance is lawful although bets and wagers usually are unlawful?

(c) What is meant by insurable interest?

(d) Give an example of subrogation in relation to insurance.

(e) What is meant by general average?

No. 12 (10 points):

State the general principles underlying a common carrier's liability for loss or damage to goods shipped by freight.

Accounting Theory and Practice—Part II

NOVEMBER 15, 1935, 1:30 P. M. TO 6:30 P. M.

Solve problems 1 to 5 and two of the four problems 6 to 9.

No. 1 (30 points):

The following is a summary of an analysis of the "investment in subsidiary companies" account in the ledger of the "P" Company as at June 30, 1935:

Company	Class of stock	Number of shares issued and outstanding	Number of shares owned	Amount at which shares are carried	Last dividend paid or declared for the period ended
"A" Company	7% First preferred.....	5,000	4,000	$200,000	June 30, 1932
	7% Second preferred...	5,000	4,900	245,000	June 30, 1932
	Common.............	10,000	9,990	100,000	Sept. 30, 1929
"B" Company	7% Cumulative pref...	10,000	8,000	800,000	June 30, 1933
	Common.............	10,000	10,000	1,000,000	June 30, 1933
"C" Company	6% Cumulative pref...	5,000	4,500	450,000	Sept. 30, 1934
	Common.............	5,000	5,000	500,000	Sept. 30, 1934
				$3,295,000	

The certificate of incorporation of the "A" Company stipulates that in the event of dissolution the 7% first preferred stock shall be entitled to $75 per share before any distribution is made to holders of any other class of stock, and no more. It further provides that after $75 per share has been distributed to the holders of the 7% first preferred stock the holders of the 7% second preferred stock shall be entitled to receive $62.50 per share before any distribution is made to the holders of the common stock, and no more. The balance is to be distributed to the holders of the common stock.

The certificate of incorporation of the "B" Company stipulates that, in the event of liquidation or winding up, the 7% cumulative preferred stock shall be entitled to $105, plus all dividends, before any distribution is made to the holders of the common stock, and no more. The balance is to be distributed to the holders of the common stock.

The certificate of incorporation of the "C" Company stipulates that after providing for all unpaid dividends on the 6% cumulative preferred stock the holders of the preferred and common stocks shall, in the event of dissolution, liquidation or winding up, be entitled, share and share alike, to all remaining assets.

A condensed summary of the assets and liabilities of the several companies as at June 30, 1935, is shown on page 282.

No. 2 (20 points):

The Clark Manufacturing Company is being operated by a committee of its creditors and you are called in to prepare financial statements for information of the creditors. Your examination reveals the following:

1. After the creditors' committee had taken charge, but before the date of your examination, a fire had occurred causing an estimated damage of $80,000, made up as follows:

Machinery and equipment.... (Book value less depreciation)	$50,000
Inventories	20,000
Customers' merchandise on hand for work to be done thereon	10,000
	$80,000

	"A"	"B"	"C"	"D"	"P"
Current assets	$450,000	$1,000,000	$1,200,000	$150,000	$100,000
Treasury stock:					
600 shares of "D" Company common	....	....	....	6,250	....
Investments:					
1,000 shares of "B" Company	....	....	....	....	....
7% cumulative preferred	50,500	....	....	....	....
9,000 shares of "D" Company common	....	....	112,500	....	....
Per analysis	....	....	....	....	3,295,000
Fixed assets, less depreciation	200,000	1,200,000	200,000	17,000	....
Other assets	9,500	165,000	27,500	250	25,000
Total assets	$710,000	$2,365,000	$1,540,000	$173,500	$3,420,000
Current liabilities	$85,000	$165,000	$240,000	$26,250	$70,000
Mortgages payable	....	300,000	....	....	....
Capital stock					
7% First preferred	250,000	....	....	....	....
7% Second preferred	250,000	....	....	....	....
7% Cumulative preferred	....	1,000,000	....	....	....
6% Cumulative preferred	....	....	500,000	....	....
Common	100,000	1,000,000	500,000	100,000	3,000,000
Surplus or *deficit*	25,000	*100,000*	300,000	47,250	350,000
Total liabilities	$710,000	$2,365,000	$1,540,000	$173,500	$3,420,000

Prepare a schedule of the minority interest, assuming liquidation at book value.

(The building occupied was leased and not owned.)

The company had accepted from the insurance companies $57,080 in full settlement for the loss, and this amount was still on deposit at the date of your examination. The cost of clearing the debris and obtaining the equipment considered necessary would be $47,250.

2. There is $130,112 in accounts and notes payable to creditors, parties to an agreement whereby each creditor accepted a note of the corporation, due October 31, 1937, and bearing interest at 5% per annum. The notes are secured by mortgage on all plant property and by all the issued capital stock. The latter is held in escrow. There will be $13,348 interest accrued on the notes at maturity.
3. Expenses have accrued to the amount of $1,532.
4. There is due to the president $30,000 for salary and cash advances for which the corporation gave him a demand note. A part of the agreement with the creditors was a covenant by the president to take capital stock for this note at par. The president could not surrender the note, however, because he had used it as collateral to secure a personal loan. The stock had therefore not yet been issued.
5. There is a corporation note dated February 1, 1931, payable on demand to the widow of the former treasurer, for $6,900. She has agreed to subrogate her claims to those of the other creditors.

6. The liabilities incurred since the creditors entered into the agreement aggregate $15,699.
7. There are $17,400 notes payable for equipment purchased prior to the creditors' agreement, due in monthly instalments of $2,175 each and secured by chattel mortgage on the equipment.
8. Balances aggregating $3,066 are due employees under an arrangement whereby they received 90% of their earnings in cash and 10% in scrip payable October 31, 1937.
9. A deficit of $178,032 existed at the date of the creditors' agreement. The subsequent loss from operations is $8,942 before adjustment of the fire loss.
10. The authorized capital stock is 150,000 shares of $10 each, of which 50,000 shares are issued and outstanding and placed in escrow for the benefit of creditors. Of the unissued 100,000 shares 5,350 were subscribed in 1928 but the subscriptions were never paid. They are of doubtful status and are given to the creditors' attorney for collection.

From the foregoing data prepare the liabilities side of the balance-sheet as you would submit it to your client, together with footnotes to the balance-sheet which in your opinion are necessary for a clear understanding of the corporation's financial position.

No. 3 (18 points):

Company D makes ferro-chrome at a cost of $127 a ton. The product is sold to Company F at $160 a ton.

Company E makes spiegeleisen (ferro manganese) at a cost of $71 a ton. This is sold to Company F at $90 a ton.

Company F makes steel, some being Bessemer steel and some open-hearth chrome steel, using products of Companies D and E.

Its manufacturing statistics show:

Bessemer:		
Materials—		
Pig	105	tons
Spiegeleisen	6	"
	111	"
Loss of weight in manufacturing	11	"
Tons of ingots produced	100	"
Chrome steel:		
Materials—		
Pig	65	tons
Scrap	20	"
Ore	10	"
Ferro-chrome	15	"
	110	"
Loss of weight in manufacturing	10	"
Tons of ingots produced	100	"

It is further shown that in converting ingots into shapes there is a further loss of 10 per cent of the weight of the ingots.

The inventory of Company F shows:

370 tons spiegeleisen
1,200 tons ferro-chrome
9,000 tons Bessemer shapes
23,000 tons Bessemer ingots
18,000 tons chrome steel shapes
46,000 tons chrome steel ingots.

The total inventories before adjustment are:

Company D	$120,000
" E	315,000
" F	7,330,000
	$7,765,000

What is the value of the consolidated inventory after eliminating the intercompany profit?

No. 4 (12 points):

On January 1, 1934, a partnership was formed by Payson, Coleman and Burtis. They agreed to contribute $25,000 each, the profits to be shared equally. Coleman, however, put in only $15,000 while Payson put in $35,000 but Burtis did as agreed. Interest at 6% was to be paid on these capital differences and settled between the partners. No interest was to be credited on capital but they were to be charged 6% on drawings. At the close of the year 1934 the interest on drawings was: Payson $425, Coleman $275 and Burtis $315. The firm then owned $50,000 on a note dated August 31, 1934, and due August 31, 1936, interest payable semi-annually at the rate of 6% per annum. The partnership was on a calendar year and accrual basis.

Coleman bought for his own account on January 2, 1934, $15,000 of good 4½% municipal bonds and $15,000 of good 5% public utilities bonds. The interest on the municipal bonds was due January 1st and July 1st; interest on the utility bonds was due April 1st and October 1st. On March 15th he borrowed for himself $20,000 at 6% with these bonds as collateral ($10,000 on each block of bonds) and his loans were renewed on July 15th and November 15th. Coleman's individual tax return was on a cash basis.

How should the interest be reported on the partnership's and Coleman's federal income-tax returns?

No. 5 (10 points):

The unaudited accounts for the year 1934 of the Bilt-Well Furniture Company are as follows:

Balance-sheet—December 31, 1934.

Assets	
Cash	$8,000
Accounts receivable	50,000
Inventory	343,000
	$401,000
Liabilities	
Notes payable	$25,000
Trade creditors	45,000
Reserve for bad debts	8,000
Capital stock	150,000
Surplus	173,000
	$401,000

Surplus and Profit-and-Loss Account year ended December 31, 1934.

Sales	$230,000
Cost of sales	183,000
Gross profit	$47,000
Expenses	$72,000
Bad debts	16,000
	$88,000
Loss for the year	*$41,000*
Surplus at January 1, 1934	214,000
Surplus at December 31, 1934	$173,000

An examination discloses that at the end of the year 1934 the following adjustments are necessary:

To reduce inventory to market by	$125,000
To increase reserve for bad debts by	8,000
To set up the liability for:	
Commissions payable to salesmen	5,000
Sundry expenses	2,000

The examination further reveals the following adjustments at the beginning of the year that were accepted by the company but had not been taken up on the books:

Reduction of inventory to market	$100,000
Increase of reserve for bad debts	19,000
Provisions for:	
Unrecorded liabilities	3,000
Commissions due salesmen	1,500

Prepare adjusted accounts.

No. 6 (5 points):

A company refunds a bond issue of $5,000,000 principal amount of 6½% bonds, due five years hence, on which there is still an unamortized debt discount and expense of $250,000, by the issuance of $5,500,000 principal amount of 5½% twenty year bonds at 90. The difference between the amount of cash necessary to retire the old bond issue and the amount produced by the refunding bonds is supplied from the general funds of the company. The expenses of the new issue are $50,000.

Discuss briefly three procedures which may be followed by the company to dispose of the unamortized debt discount and expense applicable to the old issue and list them in the order of your preference.

No. 7 (5 points):

A company with a capital of $25,000,000 contracted for the construction of a new building at its factory. This contract was formally authorized and accepted by the board of directors. Construction commenced in October, 1934, and at December 31, 1934, the engineers estimated that in addition to the payments already made to the contractors, $2,500,000 was necessary to complete the building.

What disclosure do you deem necessary on the December 31, 1934, balance-sheet—

1. If the company's cash balance is adequate and no new financing is intended and
    (a) in case the amount has been formally appropriated
    (b) when not definitely appropriated.
2. If arrangements had been completed early in January, 1935, to raise the $2,500,000 through an issue of bonds.

No. 8 (5 points):

A manufacturer of refrigerators had 4,000 units of a 1933 model on hand at December 31, 1934. In February, 1935, prior to the completion of your audit, these units were disposed of as a job lot for $50,000. Their original cost had been $310,000 and their inventory value at December 31, 1933, was $248,000.

Assuming that the offer had been under consideration prior to December 31, 1934, what would be your opinion of the contention that, since no fair market value existed at the end of the year, the original cost of $310,000 should be restored as the inventory value? Would your conclusion concerning the proper valuation in the balance-sheet of December 31, 1934, be modified if the offer had not been received until February?

No. 9 (5 points):

1. Define a co-insurance clause in an insurance policy.

2. A company carried $50,000 insurance. The policy contained a co-insurance clause stating that the insured agreed to carry insurance to the amount of 80% of the

value of the company's insurable assets or become a co-insurer. The company had a fire loss amounting to \$40,000. The insurable assets at the time of the fire amounted to \$100,000. How much insurance is the company entitled to collect from the insurance company?

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